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No. 80-108

IN THE

Supreme Court of the United States

October Term, 1980

FIRST PENNSYLVANIA BANK N. A.,
Petitioner

v.

JAY A. ZEFFIRO and HARRY M. BERNARD, JR.,
Respondents

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR WRIT OF CERTIORARI

EDWARD F. MANNINO
2600 The Fidelity Building
Philadelphia, PA 19109
(215) 546-3000
Attorney for Petitioner
First Pennsylvania Bank N. A.

Of Counsel:
DILWORTH, PAXSON, KALISH
& LEVY
MARK J. LEVIN
2600 The Fidelity Building
Philadelphia, PA 19109

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

TABLE OF CONTENTS OF BRIEF.

	Page
Counterstatement of Question Presented	1
Statutes Involved	2
Counterstatement of the Case	2
Reasons for Denying the Writ	5
A. The Factors For Implying A Cause Of Action Are Well-Settled	5
B. The Court Of Appeals Decision Is Consistent With This Court's Prior Decisions And With The Decisions Of All Other Federal Courts	6
C. The Court Of Appeals Correctly Decided This Case By Following Congressional Intent	10
D. The Court Of Appeals Decision Does Not Raise Administrative Or Federal-State Comity Issues That Merit Review By This Court	14
Conclusion	18
Appendix:	
Statutes Involved	RA 1
Notice of defaults	RA 2
Duties of the trustee in case of default	RA 3
Responsibility of the trustee	RA 3
Undertaking for costs	RA 4
Jurisdiction of offenses and suits	RA 5

TABLE OF CASES.

American Surety Co. v. Schultz, 237 U.S. 159 (1915) 13

Cannon v. University of Chicago, 441 U.S. 677 (1979) 5,7,8,9

Page

Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416 (1972) 6,7

Cort v. Ash, 422 U.S. 66 (1975) 5,10

Div. 1287, Etc. v. Kansas City Area Transp. Auth., 582 F.2d 444 (8th Cir. 1978), *cert. denied*, 439 U.S. 1090 (1979) 13

Div. No. 741, Etc. v. Greater Portland Transit District, Etc., 589 F.2d 1 (1st Cir. 1978) 13

Glus v. G. C. Murphy Co., ... F.2d .... (3d Cir. June 27, 1980) 16

Illinois v. Milwaukee, 406 U.S. 91 (1972) 16

In re Equity Funding Corp. of America Securities Litigation, 416 F.Supp. 160 (D.C.Cal. 1976) *aff'd* 603 F.2d 1353 (9th Cir. 1979) 6

International Assoc. of Machinists v. Central Airline, Inc., 372 U.S. 682 (1963) 13

Kissinger v. Reporters Committee for Freedom of the Press, ... U.S. ...., 100 S.Ct. 960 (March 3, 1980) 5

Local Div. 519, Etc. v. LaCrosse Mun. Transit U., 585 F.2d 1340 (7th Cir. 1978) 13

Matthews v. Fisher, 1980-1 Fed.Sec.L. Rep. (CCH), §97,336 (S.D. Ohio 1978) 6

Morris v. Cantor, 390 F.Supp. 817 (S.D.N.Y. 1975) 6

Santa Clara Pueblo v. Martinez, 436 U.S. 49 (1978) 7

Texas & Pacific Railway v. Rigsby, 241 U.S. 33 (1916) 16

Textile Workers v. Lincoln Mills, 353 U.S. 448 (1957) 16

Touche Ross & Co. v. Reddington, 442 U.S. 560 (1979) 5,9,12

Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979) 5,8,9,13

Page

STATUTES.

28 U.S.C. §1292(b) 4
Education Amendments of 1972, Title XI, §901(a) .. 9
Investment Advisors Act, §214 8
Railway Labor Act, Section 204, 45 U.S.C. 184 13
Securities Act of 1933:
Section 22v(a) 2
Section 77v(a) 3,12
Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.* 1,2,3,8,10,11, 12,16
Urban Mass Transportation Act, §13(c) 13

RULES.

F.R.Civ.P. 23 7
Fed.R.Civ.P. 12(b)(1) and 12(b)(6) 3

MISCELLANEOUS.

82 F.R.D. 31 (E.D.Pa. 1979) 2
Comment, *Rules of Decision in Non-diversity Cases*, 69 Yale L.J. 1428 (1960) 16
Friendly, *In Praise of Erie—And of the New Federal Common Law*, 39 N.Y.L.U.Rev. 383 (1964) 16
Scott [on Trusts] and the *Restatement of Trust*, ALI, Federal Securities Code Pt. XIII, Trust Indentures, §1305(c) Comment (4) (1980) 17
The Business Lawyer, Vol. 35, p. 161 (Nov. 1979) 17

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RESPONSE TO PETITION FOR WRIT OF CERTIORARI

Counterstatement of Question Presented

Whether the Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.*, by requiring certain provisions to be included in trust indentures and by explicitly granting jurisdiction to federal courts over all suits in equity and actions at law brought to enforce any liability or duty created by the Act, creates a private right of action, enforceable in the federal district courts, for breach by the indenture trustee of the statutorily mandated provisions.

Statutes Involved

In addition to the provisions of the Trust Indenture Act [the "Act"] set forth in First Pennsylvania's Appendix at A60-A83, the following statutory material is involved in this case and is reproduced in the Appendix to this brief at pages RA 1-RA 2:

1) Section 301 of the Act (15 U.S.C. §77aaa);

2) Section 309(d) and (e) of the Act (15 U.S.C. §77iii(d));

3) The entirety of Section 315 of the Act (15 U.S.C. §77ooo);

4) Section 319(c) of the Act (15 U.S.C. §77sss(c));

5) Section 322(b), 15 U.S.C. §77vvv(b); and

6) Section 22v(a) of the Securities Act of 1933 (15 U.S.C. §77v(a)).

Counterstatement of the Case

These consolidated class actions arise from the default in December, 1976 by Capital First Corporation ["Capital First"] in its obligations to several hundred debenture holders by failing to pay interest on its debentures issued in May, 1972. Plaintiffs, Jay A. Zeffiro and Harry M. Bernard, Jr.,[1] brought this consolidated class action on behalf of the debenture holders against the indenture trustee for the issue, Petitioner First Pennsylvania Bank, N.A. ["First Pennsylvania"]. First Pennsylvania allegedly failed, *inter alia*, to perform certain duties required by

[1] Plaintiff Isabella G. Smith withdrew as a class reprsentative for reasons of health. See 82 F.R.D. 31 (E.D.Pa. 1979).

provisions of the trust indenture which are mandated by the Trust Indenture Act of 1939, 15 U.S.C. §77aaa *et seq.* [the "Act"].[2]

These actions were brought in the United States District Court for the Eastern District of Pennsylvania pursuant to the Act, which provides for concurrent federal and state court jurisdiction over all suits in equity and actions at law brought to enforce any liability or duty the Act creates.[3]

First Pennsylvania moved to dismiss the complaints pursuant to Fed.R.Civ.P. 12(b)(1) and 12(b)(6) alleging, *inter alia*, lack of subject matter jurisdiction and failure to state a federal claim under the Act. The District Court (Bechtle, J.) denied the motions to dismiss, finding express, and alternatively, implied causes of action, noting:

> . . . it is clear that the rights of debenture holders are articulated in the Act. The question before us is whether these rights give rise to liability 'created' by the Act within the meaning of the jurisdictional grant. While this would seem to be a question of

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[2] In particular, Plaintiffs allege, *inter alia*, that First Pensylvania violated the provisions of the indenture required by the following sections of the Act: §311, 15 U.S.C. §77kkk (A71-A76), in failing to account to the debenture holders for preferential collections received four months prior to default and thereafter; §315(a)(1), 15 U.S.C. §77ooo(a)(1) (RA 1), in failing to perform the duties specifically required by the debenture prior to default (such as obtaining collateral at six month intervals); and §315(c), 15 U.S.C. §77ooo(c) (A80), in allegedly failing to act prudently to protect the debenture holders after default. The allegations of the complaints are succinctly summarized in the opinions of the Courts below at A4 and A30-A31.

[3] Section 322 of the Act, 15 U.S.C. §77vvv(b) (A80); and Section 77v(a) of the Securities Act of 1933 (RA 5).

> pure statutory interpretation—i.e., defining the word 'created' as used in the jurisdictional grant—the parties urge the Court to employ the *Cort v. Ash* [422 U.S. 66 (1975)] implied-cause-of-action analysis. The Court will employ this implied-cause-of-action analysis, despite its doubts about its complete applicability, because the *Cort v. Ash* analysis is comprehensive and includes, by necessity, an examination of the statute's structure. (Footnote omitted). 473 F.Supp. at 207 (A40).

Thereafter, First Pennsylvania was permitted to take an interlocutory appeal to the Court of Appeals for the Third Circuit pursuant to 28 U.S.C. §1292(b) (A52-A53).

After an exhaustive analysis of the Act, its legislative history and the numerous recent implied cause of action cases decided by this Court, the Court of Appeals affirmed (A1-A28),[4] concluding:

> There is no need to weigh the *Cort* factors where they all indicate that a federal cause of action exists under the Act. *Cannon*, 441 U.S. at 709. The plaintiffs are members of the protected class, congressional intent indicates the availability of a federal forum, a federal cause of action is consistent with the Act and federal jurisdiction would not intrude on a matter of state concern. The language, purpose, and legislative history of the Act all indicate a congressional intent to allow private victims to sue in federal court for breach of mandated indenture terms. (Footnote omitted) (A24)

Accordingly, the Court of Appeals held that "the Trust Indenture Act provides injured debenture holders with a federal cause of action for breach of terms mandated by the Act." (A25). Thereafter, First Pennsylvania's Petition For Rehearing *En Banc* was denied (A58-A59).

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[4] The opinion, written by Judge Rosenn was joined by Judge Higginbotham. Senior District Judge Layton, sitting by designation, dissented.

Reasons for Denying the Writ

A. The Factors For Implying A Cause Of Action Are Well-Settled.

This case is yet another request for this Court to apply the well established standards as to when a private cause of action may be implied under a federal statute. See, *e.g.*, the landmark decision of *Cort v. Ash*, 422 U.S. 66, 78 (1975) which codified the factors to be analyzed in implied cause of action cases.

More recently, this Court has elaborated upon the *Cort* factors in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co. v. Reddington*, 442 U.S. 560 (1979); and, *Cannon v. University of Chicago*, 441 U.S. 677 (1979). These factors are now so clear that in *Kissinger v. Reporters Committee for Freedom of the Press*, ... U.S. ...., 100 S.Ct. 960 (March 3, 1980) this Court noted its disinclination to further elaborate upon them:

> This Court has spent too many pages identifying the factors relevant to uncovering congressional intent to imply a private cause of action to belabor the topic here (Footnote omitted) *Id.* at 967-68.

This Court has given ample direction to the federal judiciary as to the factors relevant to uncovering congressional intent, and there is no reason to utilize this case as a vehicle to restate or refine the implied cause of action analysis.

B. The Court Of Appeals Decision Is Consistent With This Court's Prior Decisions And With The Decisions Of All Other Federal Courts.

The Court of Appeals thoroughly analyzed the Act, its legislative history, the relevant cases decided by this Court, and the decisions of all other Courts that have considered this issue, See *Morris v. Cantor,* 390 F.Supp. 817 (S.D.N.Y. 1975); *Matthews v. Fisher,* 1980-1 Fed.Sec.L.Rep. (CCH), §97,336 (S.D. Ohio 1978); and, *In re Equity Funding Corp. of America Securities Litigation,* 416 F.Supp. 160, 203 (D.C.Cal. 1976) *aff'd* 603 F.2d 1353 (9th Cir. 1979). The Court of Appeals concluded that a private cause of action may be implied under the Act.

In *Caplin v. Marine Midland Grace Trust Co.,* 406 U.S. 416 (1972), this Court, in holding that a trustee in bankruptcy lacked standing to enforce the rights of debenture holders against the indenture trustee, reserved the question of whether the debenture holders themselves could sue in federal court under the Act. This Court, however, in *Caplin* suggested the possibility of a private cause of action by the debenture holders.[5] Further, that possibility had been characterized as "not unlikely" by Judge Friendly for the Court of Appeals for the Second Circuit sitting *en banc* when *Caplin* was before that Court, 439 F.2d 118, 123 n. 5 (2d Cir. 1971).

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[5] In *Caplin* this Court stated, 406 U.S. at 426, n. 17:

> We assume, *arguendo,* that violation of 15 U.S.C. §77ooo would give rise to a cause of action against an indenture trustee by debenture holders. If there is a cause of action, 15 U.S.C. §77vvv would seem to give federal courts jurisdiction. The Court of Appeals inferred that such suits would be proper, 439

(Footnote continued on following page)

Significantly, as noted above, the Court of Appeals decision in this case neither departs from established precedent nor conflicts with the decisions of this Court or any other court. Indeed, the holding below is virtually compelled by this Court's decision in *Cannon*, which stated that with *only one* exception this Court had *never* "refused to imply a cause of action where the language of the statute explicitly conferred a right directly on a class of persons that included the plaintiff in the case," 441 U.S. at 690, n. 13,[6] and where there is no expressed intent to deny a private cause of action.[7]

(Footnote continued from preceding page)

F.2d at 123, n. 5, but did not decide the point. Since we conclude that even if such suits may be brought, petitioner lacks standing to bring them, we do not decide the question.

This Court further stated:

Because the debenture holders could bring a class action and bind all members of the class, they can make a binding settlement and avoid lengthy and expensive litigation . . ." 406 U.S. at 432-33, n. 22.

This Court further stated:

Again, we assume, *arguendo*, that the Trust Indenture Act gives a right of action to debenture holders under these circumstances. Obviously, if the debenture holders themselves have no cause of action, their surrogate is in no better position. 406 U.S. at 433, n. 23.

The Court's reference in *Caplin* to F.R.Civ.P. 23 as a "powerful remedy" (*Id.* at 433) is further evidence that actions under the Act may properly be brought in federal court.

[6] The exception was *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978), in which the relevant statute reflected a special policy against judicial intervention in Indian affairs.

[7] Thus, as this Court made clear in *Cannon*:

[I]n situations "in which it is clear that federal law had granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling." (Footnote and citation omitted, emphasis in original) 441 U.S. at 694.

The conclusion that a private remedy was intended is further compelled because, as in *Cannon* the Act explicitly confers rights on the plaintiff class but lacks any provision for administrative enforcement. As noted in *Cannon*:

> [This Court] has *never* withheld a private remedy where the statute explicitly confers a benefit on a class of persons and where it does not assure those persons the ability to activate and participate in the administrative process contemplated by the statute (Emphasis added) 441 U.S. at 703 n. 41.

The restricted rights of the SEC under the Act, see §309(e), 15 U.S.C. §77iii(e) (RA 1), stand in marked contrast with the SEC's broad rights under the Investment Advisers Act, where no private right of action for damage was implied, *Lewis*, 444 U.S. at 20 ("§209 authorizes the Commission to bring civil actions in federal court [and] §203 to impose various administrative sanctions on persons who violate the Act . . . " Moreover, the legislative history of the Investment Advisers Act demonstrated a specific intention to omit a damage remedy by removing from early drafts of a bill language similar to that found in the Trust Indenture Act. *Lewis*, 444 U.S. at 21-22.[8]

First Pennsylvania erroneously suggests that the presence of an express civil remedy for violation of one section of the Act, §323 (15 U.S.C. §77www) (A81-A82), confirms that Congress did not intend to create any fur-

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[8] Compare and contrast the expansive language of Section 322 of the Act, referring to "*suits and actions brought to enforce any* liability," with the narrow language of the jurisdictional grant in §214 of the Investment Advisors Act, referring *only* to "suits in equity to enjoin violations."

ther private right of enforcement (Petition at p. 19). This Court rejected an identical argument in *Cannon*:

> The fact that other provisions of a complex statutory scheme create express remedies has *not* been accepted as a sufficient reason for refusing to imply an otherwise appropriate remedy under a separate section ... Rather, the Court has generally avoided this type of "excursion into extrapolation of legislative intent." ... unless there is other more convincing evidence that Congress meant to exclude the remedy (Citations omitted) (Emphasis in original) 441 U.S. at 711.

Thus, there is no conflict, as First Pennsylvania erroneously contends (Petition at pp. 15-21), between the ruling below and this Court's decisions in *Lewis* and *Touche Ross*, just as those decisions do not conflict with *Cannon*.[9] While *Cannon* found an implied cause of action under one statute, *Lewis* and *Touche Ross* found no implied cause of action for damages under other, different statutes.[10] In reality, First Pennsylvania is not requesting the Court to resolve a conflict, but is requesting the Court to overrule the unanimous view that a private federal cause of action exists under the Trust Indenture Act.

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[9] Conspicuous by its absence is any reference by First Pennsylvania to *Cannon*, where a private right of action was found under §901(a) of Title IX of the Education Amendments of 1972.

[10] The Court of Appeals succinctly distinguished *Touche Ross v. Reddington* on at least six grounds; and *Transamerica v. Lewis* on four grounds (A24-A25, fn 33).

C. The Court Of Appeals Correctly Decided This Case By Following Congressional Intent.

The Court of Appeals premised its decision on a detailed analysis of the Act and on this Court's recent implied causes of action cases. Because the Court of Appeals correctly applied *Cort v. Ash* and its progeny and correctly adduced legislative intent, there is no reason for this Court to review its decision.

As noted by the Court of Appeals, "[T]he *Cort* test is basically one of statutory construction" (A13), and in this connection the Act contains numerous indications that Congress intended to create a private federal cause of action to enforce the rights created by the Act. These factors are thoroughly discussed by the Court of Appeals (A13-A25).

Moreover, the Act expressly refers to possible liabilities of the trustee and to litigation to enforce rights. Section 315(a), 15 U.S.C. §77ooo(a) (RA 1), provides that the indenture trustee may not exempt itself from liability for failure to perform the duties specifically set out in the indenture, including those duties which the Act mandates the trustee to undertake. Section 315(d), 15 U.S.C. §77ooo(d) (RA 3), expressly prohibits the indenture trustee from relieving itself from liability for negligent and wilful misconduct. Section 319(c), 15 U.S.C. §77sss(c) (RA 4), provides that "No provision of this subchapter imposing any liability" [indicating that liability is imposed by the provisions other than §323] will apply to trustee conduct taken in good faith reliance on SEC rules, regulations or orders.

Section 323(a), 15 U.S.C. §77www(a) (A81), which expressly provides for civil liability for misrepresentation and omissions in statements to the SEC, is cited by First

Pennsylvania as being the only section creating civil liability enforceable in the federal courts. Yet §323(b), 15 U.S.C. §77www(b) (A82), provides that "[t]he rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that exist under the Securities Act of 1933 ... or otherwise at law ..." Reference to "this subchapter," meaning the entire Act,[11] as opposed to "this section," meaning Section 323, implies the existence of rights and remedies in other sections as well. Likewise, the "in addition to" clause recognizes that rights and remedies may arise under the Act without being explicitly set forth therein.

Thus, the existence of a cause of action in *some* court to enforce rights created by the Act, *vis-a-vis* the indenture trustee, is undeniable.

And, indeed, First Pennsylvania concedes that indenture provisions are enforceable in the courts of the various states, but erroneously argues that they are enforceable *only* in state courts in breach of contract and breach of trust actions.[12]

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[11] The word "subchapter" referred to in Section 322 is a term of art and refers to the entire Act. See, 15 U.S.C. §77aaa, RA 1.

[12] See Petition at 9 where First Pennsylvania argues:

> [The failure to expressly provide a federal right of action] reflects a conscious congressional choice to leave the injured debt security holder to his adequate and traditional state law remedies, now fortified by federal prohibition of exculpatory provisions relieving trustees of liability.

Similarly, as noted by the Court of Appeals (A8):

> First Pennsylvania argues that, because the Act only mandates certain terms of the indenture in order for it to be qualified by the SEC, the remedy is contractual under state law, and not one for federal jurisdiction.

However, the Act's express jurisdictional section makes clear that the liabilities and duties created by the Act are enforceable in both the federal and state courts. Section 322, 15 U.S.C. §77vvv (RA 5), provides in pertinent part:

> (b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to enforce any liability created by, this subchapter, or any rules or regulations or orders prescribed under the authority thereof, shall be as provided in section 77v(a) of this title (Emphasis added).

Section 77v(a) of the Securities Act of 1933, referred to in Section 322 quoted above, provides *inter alia*:

> *The district courts of the United States ... shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations,* promulgated by the Commission in respect thereto, and, *concurrent with State and Territorial courts,* of all suits in equity and actions at law brought to enforce any liability or duty *created by this subchapter* (Emphasis added).

Since a jurisdictional provision, like §322, "creates no cause of action of its own force and effect; it imposes no liabilities [and the] source of plaintiffs' rights must be found, if at all, in the substantive provisions of the . . . Act", *Touche Ross,* 442 U.S. at 577. Here, liabilities and duties are found in the substantive provisions of the Act, as a matter of basic statutory construction. The Act "creates" liabilities and duties by mandating that specific liabilities and duties be incorporated in the indenture entered into by the indenture trustee for the benefit of the debenture holders. As noted by the District Court in *Zeffiro,* 473 F.Supp. at 209, (A45):

> [W]e find that the Act 'creates' liability for breach of the terms of an indenture in that those terms exist

> only because they are required by the Act. We find it manifestly clear that Congress 'brought those terms into existence' and do not find it relevant that the liability is 'indirectly' created by way of a contract claim.

In this case, as in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. at 19, n. 8, a construction of the Act that relegates plaintiffs to litigating in state court on purely state law grounds would be "anomalous", absent "some indication Congress in fact wished to remit the litigation of a federal right to a state court."

That federally created and enforceable rights can derive from congressionally mandated contractual provisions is not a new legal concept. See *American Surety Co. v. Schultz*, 237 U.S. 159 (1915), holding that a suit on a supersedeas bond required by federal law arises under a federal statute, and *International Assoc. of Machinists v. Central Airline, Inc.*, 372 U.S. 682 (1963), holding that an action to enforce the award of a board of adjustment established by a contract between an airline and union "arises under" federal law because Section 204 of the Railway Labor Act, 45 U.S.C. 184, required that such a board be created.[13] The language in *International Assoc. of Machinists* is particularly appropriate herein:

> The contracts and the adjustment boards for which they provide are creations of federal law and bound to the statute and its policy. If any provision contained in a §201 contract is enforceable, it is because of congressional sanction: "[T]he federal

[13] Similar reasoning has led three Circuit Courts of Appeal to conclude that a private federal cause of action exists under §13(c) of the Urban Mass Transportation Act: *Local Div. 519, Etc. v. LaCrosse Mun. Transit U.*, 585 F.2d 1340, 1345-48 (7th Cir. 1978); *Div. 1287, etc. v. Kansas City Area Transp. Auth.*, 582 F.2d 444 (8th Cir. 1978), *cert. denied*, 439 U.S. 1090 (1979) and *Div. No. 741, Etc. v. Greater Portland Transit District, Etc.*, 589 F.2d 1, 6-8 (1st Cir. 1978).

> statute is the source of the power and authority . . . The enactment of the federal statute . . . in the governmental action . . . though it takes a private agreement to invoke the federal sanction . . . A union agreement made pursuant to the Railway Labor Act has, therefore, the imprimature of the federal law upon it. That is, the §204 contract, like the Labor Management Relations Act §301 contract, is a federal contract and is therefore governed and enforceable by federal law, in the federal courts. *Id.* at 692.

In short, as the Court of Appeals concluded in this case on the basis of its extensive statutory analysis, the Act gives every indication of a congressional intent to create federal rights for debenture holders and to provide a federal remedy in a federal forum for violation of those rights by breach of the terms of the federally regulated indenture.

D. The Court Of Appeals Decision Does Not Raise Administrative Or Federal-State Comity Issues That Merit Review By This Court.

First Pennsylvania attempts to raise the spector of a "nebulous and unlimited 'Federal Trust Law' " haunting increasing numbers of indenture trustees as economic conditions deteriorate (Petition at 11, 12-13). First Pennsylvania suggests that a flood of cases under the Act might overwhelm the federal judiciary (Petition at 9, 11, 12-14) and that the basic principles of federalism might erode as a result of a diversion from state to federal courts of indenture matters allegedly only of state concern (Petition at 14-15).

Whether any of those concerns is realistic is irrelevant in that not one of them provides any basis for reversing the decision of the Court of Appeals. Nor do they establish a basis for this Court's review.

The Court of Appeals found that the Act was intended "to attack a national problem in a uniform way" (A20). That finding is virtually unassailable in light of the legislative history of the Act. As recognized by the Court of Appeals (A20):

> A necessary means of facilitating the national uniformity goal of the Act would be through enforcement of the indenture in a federal forum. It is hard to believe that Congress would have established uniform standards to govern indentures and then paradoxically have allowed the application of those standards to depend on the law of the state of the suit. The interpretation of the indenture provisions mandated by the Act does not depend on ordinary contract principles—the intent of the parties—but depends on an interpretation of the legislation (Footnote omitted) (*Id.*)

The Court continued by referring to the clear congressional intent of obtaining uniformity in the interpretation of the Act, as follows (A20-A21):

> It would be contrary to the purposes of the Act to have the trustee held to certain standards in one state court and potentially different standards in another. Thus, federal court jurisdiction is necessary to achieve the uniform standards intended by the Act (Footnote omitted).

The achievement of the desired uniformity will only require the judicial interpretation of federal legislative standards by reference to state as well as federal law

precedents.[14] Judicial interpretation of federal legislative standards, however, has never been threatening to the federal courts. See *Illinois v. Milwaukee*, 406 U.S. 91 (1972) (federal common law rights of nuisance recognized and applied to the pollution of interstate waters); *Textile Workers v. Lincoln Mills*, 353 U.S. 448 (1957) (federal labor law); and *Texas & Pacific Railway v. Rigsby*, 241 U.S. 33 (1916) (Safety Appliance Act).

Moreover, reference to state law precedent as a tool for federal statutory interpretation is an accepted practice, which does not support a conclusion that only state, and not federal, rights are implicated by a statute. See generally Friendly, *In Praise of Erie—And of the New Federal Common Law*, 39 N.Y.U.L.Rev. 383, 405 (1964) and Comment, *Rules of Decision in Non-diversity Cases*, 69 Yale L.J. 1428, 1434 (1960). With respect to the specific issues which might be raised under the Trust Indenture Act, the fact that certain statutory terms "might well receive different construction under the laws of the several states" (Petition at 11) is the very reason Congress believed it necessary that those standards be defined uniformly by the federal courts. While the federal judiciary might refer to state law concepts, not every state's interpretation need be taken into account. As

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[14] For instance, it might be necessary to develop on a case by case basis the "prudent man" standard required of a trustee after default under §315(c), 15 U.S.C. §77ooo(c) (A.80). Development of federal common law, however, is the method for filling in such statutory "interstices." See *Glus v. G. C. Murphy Co.*, ... F.2d .... (3d Cir. June 27, 1980) (Nos. 79-1507 and 1508) (Sloviter, J. dissenting):

> [F]ederal common law has been undertaken . . . where a federal statute provides both a cause of action and the rule of law but has left what has been denominated "interstices". Slip Opinion at 23.

noted by the drafters of the proposed ALI Federal Securities Code in the comments pertaining specifically to the development of a federal prudent man standard for indenture trustees by reference to state law precedent—"*Scott* [on Trusts] and the *Restatement of Trust* will continue to reign in any case!" ALI, Federal Securities Code Pt. XIII, Trust Indentures, §1305(c), Comment (4) (1980).

First Pennsylvania's fear that the federal courts will be flooded with Trust Indenture Act litigation as a result of this case is illusory. While investment in corporate bonds is admittedly a multi-billion dollar industry, past history suggests that courts will not be inundated with cases against indenture trustees.

A recent article in *The Business Lawyer,*[15] reports the results of a study on debentures by J. H. Hill, "Corporate Bond Research: Special Report XL" (Smith Barney, Harris Upham & Co., Inc. 1978), which indicates that defaults on publicly traded debt securities rarely occur. For the period 1966 through 1977 defaults on publicly distributed corporate bonds averaged less than fifteen one-hundredths of one percent (0.15 percent) of the principle of publicly issued corporate bonds outstanding.[16]

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[15] R. Smith, S. Case and F. Morison. "The Trust Indenture Act of 1939 Needs No Conflict of Interest Revision," *The Business Lawyer,* Vol. 35, p. 161 (Nov. 1979).

[16] Default was defined for purposes of the study as the missing of an interest or principal payment by the borrower. Annual default rates were calculated by contrasting the principal amount of defaulted bonds against the principal amount of total corporate bonds in good standing. See Hill Study p. 165, n. 13.

Furthermore, in the 40 years since passage of the Act, there have been a mere handful of cases filed in the state courts for breach of trust indentures. Moreover, even if this decision were reversed, litigation arising under trust indentures could and undoubtedly would end up in federal courts under diversity and pendent jurisdiction principles.

In short, where, as here, Congress intended the federal courts to enforce a federal statute, the courts have an obligation to fulfill that mandate. The alleged fear that federal courts will become embroiled in areas of law which might require analysis of state law principles to develop, and that they could be called on to handle large numbers of new cases, does not justify review of this case or reversal of the Court of Appeals.

Conclusion

The standards for implying a federal cause of action are well established and were strictly followed by the Court of Appeals. Moreover, this case has been correctly decided in accordance with congressional intent, and it follows the unanimous view of all other federal courts deciding this identical question.

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

DANIEL M. BERGER,
BERGER, KAPETAN, MALAKOFF
& MEYERS, P.C.,
508 Law and Finance Building,
Pittsburgh, PA 15219,
(412) 281-4200.

ABRAHAM C. REICH,
FOX, ROTHSCHILD, O'BRIEN
& FRANKEL,
2000 Market Street,
Philadelphia, PA 19103,
(215) 299-2090.

ROBERT J. HENNESSEY,
LARKIN, HOFFMAN, DALY
& LINDGREN, LTD.,
1500 Northwestern Financial Center,
7900 Xerxes Avenue, South,
Minneapolis, Minnesota 55431,
(612) 835-3800,

Attorneys for Respondents,
Jay A. Zeffiro and
Harry M. Bernard, Jr.

Of Counsel:

Michael P. Malakoff,
Richard A. Finberg,
508 Law & Finance Building,
Pittsburgh, PA 15219.

Joseph W. Anthony,
Larkin, Hoffman, Daly
& Lindgren, Ltd.,
1500 Northwestern Financial Center,
7900 Xerxes Avenue, South,
Minneapolis, Minnesota 55431.

Appendix.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2259

ZEFFIRO, Jay A., individually and on behalf of all other persons similarly situated

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY, a Pennsylvania Corporation

SMITH, Isabella G., BERNARD, Harry M. Jr., on behalf of themselves and all others similarly situated

v.

FIRST PENNSYLVANIA BANK, N. A.
CAPITAL FIRST CORPORATION

FIRST PENNSYLVANIA BANK, N. A.,
Appellant

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
(D. C. Civil Nos. 78-3294 and 78-4316)

Argued February 21, 1980

Before: ROSENN and HIGGINBOTHAM, *Circuit Judges* and LAYTON, *District Judge* *

* Honorable Caleb R. Layton, 3rd, Senior United States District Judge for the District of Delaware, sitting by designation.

(Opinion Filed May 29, 1980)

EDWARD F. MANNINO, ESQUIRE,
(Argued)
MARK J. LEVIN, ESQUIRE
Dilworth, Paxson, Kalish,
Levy & Kauffman
2600 The Fidelity Building
Philadelphia, Pennsylvania 19109
Attorneys for Appellant,
First Pennsylvania Bank, N. A.

MICHAEL P. MALAKOFF, ESQUIRE
(Argued)
RICHARD A. FINBERG, ESQUIRE
Berger, Kapetan, Malakoff & Meyers
508 Law & Finance Building
Pittsburgh, Pennsylvania 15219

JOSEPH W. ANTHONY, ESQUIRE
Larkin, Hoffman, Daly &
Lindgren, Ltd.
1500 Northwestern Financial Center
7900 Xerxes Avenue South
Minneapolis, Minnesota 55431

ABRAHAM C. REICH, ESQUIRE
Fox, Rothschild, O'Brien & Frankel
2000 Market Street, 10th Floor
Philadelphia, Pennsylvania 19103
Attorneys for Plaintiffs-Appellees,
Jay A. Zeffiro and
Harry M. Bernard, Jr.

RALPH C. FERRARA
General Counsel
JACOB H. STILLMAN (Argued)
Associate General Counsel
ELISSE B. WALTER
Assistant General Counsel
ROBERT J. MILLS
Attorney
Securities and Exchange Commission,
Amicus Curiae
Washington, D. C. 20549

OPINION OF THE COURT

[Entered May 29, 1980]

ROSENN, *Circuit Judge.*

The Trust Indenture Act of 1939, 15 U. S. C. § 77aaa *et seq.*, regulates the terms of the agreement between debenture holders and the indenture trustee. This appeal presents to a United States Court of Appeals for the first time the question of whether the Act provides an injured investor with a cause of action in federal court against a trustee for breach of the agreement. We conclude, as did the district court, that a cause of action exists under the Act, allowing injured investors to bring suit in federal court.

I.

Jay A. Zeffiro and Harry M. Bernard, Jr. each hold debentures issued in 1972 by Capital Equipment Leasing Corporation, a predecessor of defendant Capital First Corporation ("Capital"). The debentures were issued under a trust indenture which named First Pennsylvania Banking and Trust Company, a predecessor of de-

fendant First Pennsylvania Bank, N. A. ("First Pennsylvania"), as indenture trustee. The indenture contained provisions mandated by the Act, detailing the duties of First Pennsylvania toward the debenture holders. In December 1976, Capital defaulted on its obligation to pay interest on the debentures and, subsequently, filed a petition under Chapter XI of the Bankruptcy Act.

Zeffiro and Bernard filed separate suits in the United States District Court for the Eastern District of Pennsylvania, later consolidated, alleging that First Pennsylvania breached certain duties imposed upon it by indenture provisions which were required by the Act and seeking damages.[1] First Pennsylvania moved under Rules 12(b)(1) and 12(b)(6) to dismiss the actions for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted. First Pennsylvania contended that the Act does not expressly provide for a federal cause

1. In particular, they allege that First Pennsylvania failed to segregate assets it received as a creditor of Capital within four months of Capital's default of payment in violation of an indenture provision required by section 311(a) of the Act, 15 U. S. C. § 77kkk(a); that First Pennsylvania failed to transmit certain reports to the debenture holders and made misleading statements in the reports it did transmit in violation of an indenture provision mandated by section 313, 15 U. S. C. § 77mmm; and that First Pennsylvania failed to disqualify itself in violation of a provision mandated by section 310(b), 15 U. S. C. § 77jjj(b), when a conflict of interest arose between it and debenture holders. In addition, plaintiffs allege that First Pennsylvania failed to notify the debenture holders of Capital's default in violation of a provision mandated by Section 315(b), 15 U. S. C. § 77ooo(b); and that First Pennsylvania failed to take a number of actions after Capital's default, including actions to preserve the collateral securing the debentures as mandated by section 315(c), 15 U. S. C. § 77ooo(c). Plaintiffs also allege that First Pennsylvania breached indenture provisions not mandated by the Act, was negligent and violated its fiduciary obligations to the debenture holders.

of action or for federal jurisdiction and that, therefore, the debenture holders' suit must be brought in state court. Judge Bechtle denied the motions, holding that there is a federal cause of action in favor of debenture holders for breach of the provisions of a trust indenture when those provisions are mandated by the Act. 473 F. Supp. 201 (E. D. Pa. 1979). The district court and this court certified First Pennsylvania's right to appeal this interlocutory order under 28 U. S. C. § 1292(b).

II.

Before proceeding to a discussion of the merits, it may be useful to briefly outline the structure and background of the Trust Indenture Act. A study was conducted by the Securities Exchange Commission (SEC) in 1936 which revealed widespread abuses in the issuance of corporate bonds under indentures.[2] The main problems identified by the study were that the indenture trustee was frequently aligned with the issuer of the debentures and that the debenture holders were widely dispersed, thereby hampering their ability to enforce their rights. Furthermore, courts frequently enforced broad exculpatory terms of the indenture inserted by the issuer, which offered the investors less protection than the traditional standards of fiduciary duty.

Rather than allow the SEC direct supervision of trustee behavior and thereby provide for a more overt intrusion into capital markets, the Act establishes a standard of behavior indirectly by refashioning the form of the

2. *See* Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part IV, Trustees Under Indentures (1937); *See also* Hearings on H. R. 10292 Before a Subcommittee of the Committee on Interstate and Foreign Commerce, 75th Cong. 3d Sess. 20 (1938).

indenture itself. The Act is structured so that before a debt security non-exempted from the Act may be offered to the public, the indenture under which it is issued must be "qualified" by the SEC. The indenture is deemed "qualified" when registration becomes effective.[3] Before registration of the debenture is declared effective it must be qualified under the following conditions: (1) the security has been issued under an indenture; (2) the person designated as trustee is eligible to serve; and (3) the indenture conforms to the requirements of §§ 310-318, 15 U. S. C. §§ 77jjj-77rrr. Judge Bechtle aptly described the operative provisions of the Act, §§ 310-318, as follows.

> Sections 310 through 318 form the core of the Act in that they outline the substantive duties that the indenture must impose on the trustee. These sections are of three types. The first type is proscriptive in nature, prohibiting certain terms. For example, § 315, 15 U. S. C. § 77ooo(d), prohibits provisions in the indenture which would relieve or exculpate the trustee from liability for negligence. The second type of section is merely permissive in nature. An example of this type of section is § 315(a), 15 U. S. C. § 77ooo(a)(1), which states that the indenture *may* contain a provision relieving the trustee of liability except for the performance of such duties as are specifically set out in such indenture.
>
> The third type of section, and the most important for our purposes, is mandatory and prescriptive in nature. These sections begin with the phrase "indenture to be qualified *shall* provide" or "shall require."

3. § 309, 15 U. S. C. § 77iii. Securities not required to be registered under the 1933 Act are deemed "qualified" when the SEC permits the "application for qualification" to become effective. § 309(a)(2), 15 U. S. C. § 77iii(a)(2). The indenture must still conform to the requirements of §§ 310-318.

> An example of this type of section is § 311, 15 U. S. C. § 77kkk, which states that the indenture *shall* require the trustee to establish certain accounts for the benefit of bond holders in the event the trustee also becomes a creditor of the issuer and the issuer defaults on the bonds.

473 F. Supp. at 206.

The SEC has no enforcement authority over the terms of the indenture once the registration statement becomes effective, and it cannot issue a stop order for violation of indenture provisions by the indenture trustee. After the effective date of the indenture the SEC's role is limited to general rulemaking and investigation. 15 U. S. C. §§ 77ddd(c), (d), (e); 77 eee(a), (c); 77ggg; 77sss; 77ttt. The Act contains criminal liability for certain willful violations and misrepresentations [4] and express civil liability for any omission or misstatement in the filing documents.[5]

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4. Section 325 provides:

> Any person who willfully violates any provision of this subchapter or any rule, regulation, or order thereunder, or any person who willfully, in any application, report, or document filed or required to be filed under the provisions of this subchapter or any rule, regulation, or order thereunder, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

15 U. S. C. § 77yyy.

5. Section 323 provides in pertinent part:

> (a) Any person who shall make . . . any statement in any application, report, or document filed with the Commission . . . which statement was at the time . . . false or misleading with respect to any material fact, or who shall omit to state any

Enforcement of the terms of the indenture is left to the parties. The plaintiffs in this case contend that the Act necessarily allows for enforcement of the indenture in federal court to insure compliance with the Act. First Pennsylvania argues that, because the Act only mandates certain terms of the indenture in order for it to be qualified by the SEC, the remedy is contractual under state law and not one for federal jurisdiction.

III.

The plaintiffs'[6] first argument is that the Act *expressly* creates a federal cause of action. In *Cort v. Ash*, 422 U. S. 66 (1975), the Supreme Court set out four factors to aid in determining whether a statute creates an *implied* federal cause of action.

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with

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5. (Cont'd.)

material fact required to be stated therein or necessary to make the statements therein not misleading, shall be liable to any person (not knowing that such statement was false or misleading or of such omission) who, in reliance upon such statement or omission, shall have purchased or sold a security issued under the indenture to which such application, report, or document relates, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading or of such omission.

15 U. S. C. § 77www.

6. Unless indicated otherwise the term "plaintiffs" refers to Zeffiro, Bernard and the SEC, *amicus curiae* in this case.

> the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

422 U. S. at 78. Since *Cort*, the Supreme Court has been reluctant to imply private rights of action under the securities laws.[7] Thus, plaintiffs' argument in favor of an *express* private right of action is an apparent attempt to escape the perceived strictures of the *Cort* analysis.

The cornerstone of plaintiffs' first argument in favor of an express federal cause of action is the jurisdictional provision of the Act, section 322, which provides:

> (b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to *enforce any liability created by, this subchapter,* or any rules or regulations or orders prescribed under the authority thereof, shall be provided in section 77v(a) of this title.[8]

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7. *See e.g.*, Transamerica Mortgage Advisors, Inc. v. Lewis, — U. S. —, 48 U. S. L. W. 4002 (Nov. 13, 1979); Touche Ross & Co. v. Reddington, 442 U. S. 560 (1979); Piper v. Chris-Craft Ind., Inc., 430 U. S. 1 (1977). In Rogers v. Frito-Lay, Inc., 611 F. 2d 1074, 1088 (5th Cir. 1980), Judge Goldberg, in dissent, appropriately described the prevailing trend when he stated: "Only a cave dweller or other layman would not realize that there has been a remarkable change of attitude by the Supreme Court regarding the inference of private rights of action in the last fifteen years."

8. 15 U. S. C. § 77vvv(b) (emphasis added), 15 U. S. C. § 77v(a) states, in pertinent part:

> (a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the

The argument is essentially that the mandated provisions of the indenture were "created by" the Act, and thus section 322 confers federal jurisdiction in suits for breach of such indenture terms.

Two cases which have considered a private right of action under the Act[9] have accepted this argument, holding that section 322 expressly confers federal jurisdiction.[10] In *Morris v. Cantor,* 390 F. Supp. 817, 822 (S. D. N. Y. 1975), the court reasoned that the Act provided an "indirect method of imposing nationally uniform and clearly defined obligations," and therefore the terms of the indenture were "created by" the Act and en-

8. (Cont'd.)

rules and regulations promulgated by the Commission in respect thereto, and concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. . . .

9. In Caplin v. Marine Midland Grace Trust Co., 406 U. S. 416, 426 n. 17 (1972), the Supreme Court left open the issue of whether a federal private right of action exists under the Act.

10. The district court in this case apparently also believed there was an express federal cause of action but proceeded to the implied cause of action *Cort* analysis at the urging of the parties, stating:

> The *Morris v. Cantor* court apparently did not consider this issue to be one of an implied remedy, because it did not cite or rely on any cases preceding *Court v. Ash* [sic]. The *Morris* court simply determined that liability was "created" by the Act for violation of the indenture within the meaning of the jurisdictional grant. While we agree with that court's conclusion and approve of its analysis, this Court will apply the broader *Cort* analysis at the urging of the parties.

473 F. Supp. at 207 n. 8.

In *Mathews v. Fisher,* [current binder] Fed. Sec. L. Rep. (CCH) 97,336 (S. D. Ohio 1978), the court found a private right of action under the Act after undertaking the *Cort* analysis.

forceable in federal court. In *In Re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161, 203 (C. D. Cal. 1976) *aff'd* 603 F. 2d 1353 (9th Cir. 1979), the court adopted the *Morris* rationale, holding that the Act established a basis for liability by mandating the terms of the indenture and therefore expressly provided for federal jurisdiction.

We decline to follow the approach of *Morris* because it was decided prior to *Cort* and thus the trial judge did not have the advantage of the thorough analysis enunciated by *Cort*.[11] There is not a bright dividing line between a test for express liability on the one hand and the *Cort* test for implied liability on the other. The *Cort* test is an interpretative tool to determine if a cause of action has been in fact created, not an alternative rule to be applied when a cause of action is not expressly stated under the statute. In other words, the *Cort* test is a means of determining whether a statute intended to create a cause of action. In *Touche Ross & Co. v. Reddington*, 442 U. S. 560, 575-76 (1979), the Court noted that "[t]he first three factors discussed in *Cort*—the language and focus of the statute, its legislative history and its purpose . . . —are ones traditionally relied upon in determining legislative intent." In fact, plaintiff's argument that there is an express federal remedy—language of the statute, legislative history, consistency of

11. Although *Morris* was handed down several months before *Cort*, the *Morris* opinion failed to mention National R. R. Passenger Corp. v. National Ass'n of R. R. Passengers, 414 U. S. 453 (1974) (Amtrak Case), a case which foreshadowed the *Cort* test. It has been suggested, however, that the *Morris* opinion implicitly followed the *Cort* analysis by justifying its holding in terms of legislative intent and purpose. *See* Dropkin, *Implied Civil Liability Under the Trust Indenture Act: Trends and Prospects*, 52 Tul. L. Rev. 299, 324-25 (1978).

a federal forum with the structure of the Act—are precisely the *Cort* factors.

Moreover, it is unlikely that section 322 in itself can provide the basis for federal jurisdiction. In *Touche Ross* the plaintiffs argued that section 17(a) of the 1934 Act, 15 U. S. C. § 78q(a), provided a private federal right of action because section 27 of the Act grants to federal district courts the exclusive jurisdiction of violations of the Act and suits to enforce any liability or duty created by the Act or the rules and regulations thereunder.[12] The Court rejected the argument, holding that section 27 "creates no cause of action of its own force and effect" but that "plaintiff's rights must be found, if at all, in the substantive provisions of the 1934 Act. . . ." 442 U. S. at 577. The operative language of section 322 of the Act is identical to that in section 27. Thus, it does not appear that section 322, by itself, can be read to expressly authorize federal jurisdiction.

Plaintiffs also contend that the Act expressly provides for a federal cause of action under 28 U. S. C. §§ 1331, 1337, which confer federal jurisdiction on all matters "arising under" federal law. They argue that because the Act mandates certain terms in the indenture, enforcement of the indenture arises under federal law. Plaintiffs rely, for example, on *International Association of Machinists v. Central Airlines, Inc.*, 372 U. S. 682

12. Section 27 provides in relevant part:

> The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to *enforce any liability or duty created by this chapter* or the rules and regulations thereunder.

15 U. S. C. § 78aa (emphasis added).

(1963), where the Court held that an action to enforce the award of a board of adjustment established by a contract between an airline and the union representing its employees "arises under" federal law because Section 204 of the Railway Labor Act, 45 U. S. C. 184, required that such a board be created.

We believe the "arising under" analysis of *International Association* is not helpful to the resolution of this case and was implicitly overruled by *Cannon v. University of Chicago*, 441 U. S. 677, (1979). In *Cannon*, 441 U. S. at 690-93 n. 13, the Court characterized *International Association* as an implied private rights of action case, thereby indicating that the *Cort* test was the relevant inquiry. Justice Powell, in dissent, explained the reasoning as follows:

> Where a court decides both that federal-law elements are present in a state-law cause of action, and that these elements predominate to the point that the action can be said to present a 'federal question' cognizable in federal court, the net effect is the same as implication of a private action directly from the constitutional or statutory source of the federal-law elements.

441 U. S. at 746 n. 17. The relevant factors in the "arising under" inquiry are identical to those determining the existence of a private federal cause of action. Therefore, we turn now to the *Cort* analysis.

IV.

The *Cort* test is basically one of statutory construction. In *Transamerica Mortgage Advisors, Inc. v. Lewis*, *supra* — U. S. at —, 48 U. S. L. W. at 4002, the Court indicated "what ultimately must be determined is whether

Congress intended to create the private remedy asserted, as our recent decisions have made clear." In *Touche Ross & Co. v. Reddington, supra* 442 U. S. at 575, the Court stated that in *Cort v. Ash* "the Court did not decide that each of these factors is entitled to equal weight. The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action." In *Cannon v. University of Chicago, supra* 441 U. S. at 694, the Court observed that Congress' failure to expressly consider private remedies does not preclude a holding that Congress intended to imply one. Thus, the *Cort* test is the lodestar for guiding a court in determining legislative intent. *National Sea Clammers Association v. City of New York,* No. 79-1360, slip op. at 14-15 (3d Cir. Feb. 4, 1980).

The first question under *Cort* is whether the Act was enacted for the benefit of a special class of which debenture holders are members. 422 U. S. at 80-82. "That question is answered by looking to the language of the statute itself." *Cannon, supra* 441 U. S. at 689. An examination of the language of the Act and the surrounding legislative history makes it clear that debenture holders are the special beneficiaries of the Act.

Section 302 of the Act, 15 U. S. C. § 77bbb indicates that the purpose of the Act is to benefit the "national public interest and the interest of investors." In *In re Pittsburgh & Lake Erie Railroad Co. Securities & Antitrust Litigation,* 543 F. 2d 1058, 1067 (3d Cir. 1976), a case dealing with a debenture trustee's standing to contest the settlement of a derivative suit, this court stated:

> [T]he evident intention of Congress, in passing the Trust Indenture Act . . . [was] to increase the protection of investors who depend upon the security which an indenture trustee holds in their interest.

See also In re Multiponics, Inc., 436 F. Supp. 1072, 1075 (E. D. La. 1976).

Furthermore, an examination of the legislative history of the Act illustrates that debenture holders are the primary beneficiaries of the Act.[13] For example, both the Senate and House reports state that "enforcement of the provisions of the indenture may appropriately be left to the bondholders themselves. . . ."[14] In supporting the pending act, Justice Douglas, then Chairman of the SEC, testified before a House Committee that "the philosophy of this bill is that in the drafting of these indentures the interests of the security holders have not been adequately represented."[15] Just prior to Senate approval of the bill, Senator Wheeler noted that the Act "is of great moment to thousands of public investors. . . ."[16]

13. *See e.g.*, Hearings on H. R. 10292 before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 75th Cong. 3d Sess. (1938), ("Hearings") at 19-23, 25, 29, 57, 61; Senate Committee on Banking and Currency, Report on the Trust Indenture Act of 1939, S. Rep. No. 248, 76th Cong. 1st Sess. (1939) ("Senate Report") at 2, 3, 8; H. R. Rep. No. 1016, 76th Cong. 1st Sess. (1939) ("House Report") at 2, 24-25, 26, 27, 37; 84 Cong. Rec. 5019 (remarks of Sen. Wheeler).

14. Senate Report at 8; House Report at 26.

15. Hearings at 29.

16. 84 Cong. Rec. 5019. A further indication that Congress viewed a private right of action by the debenture holders is in § 315, 15 U. S. C. § 77ooo(e), a provision for the undertaking of costs. The section allows the parties to include a term in the indenture that in the event a debenture holder brings suit, the court, in its discretion, may require a bond and assess costs. However, the section does not require costs and a bond in any suit instituted by debenture holders, owning in the aggregate more than 10 percent of the outstanding debentures. This provision plainly indicates that Congress contemplated suits by the debenture holders to enforce the agreement.

Thus, it is evident that debenture holders are members of the special class to be protected by the Act. Congress sought to protect investors by prescribing mandatory terms of the indenture. Although this factor points towards a federal cause of action, the other factors must also be examined.[17]

The second part of the *Cort* analysis calls for an examination of the legislative history of the Act. 422 U. S. at 82. While we are not at liberty to find a cause of action solely from Congressional silence, *Touche Ross, supra* 442 U. S. at 571, such silence does not preclude finding a cause of action when the other elements of the *Cort* test are satisfied, *Cannon, supra* 441 U. S. at 694.[18]

The legislative history of the Act does not explicitly deal with the ability of investors to bring suit in federal court. As discussed *ante*, the Act was designed to regulate debt offerings in an indirect way. This sentiment was expressed in the Senate Report, which states:

> The Commission's work will be completed when the form of indenture has been qualified under the bill. . . . The Commission will have no powers with respect to the enforcement of the provisions of the indenture. *After the indenture has been executed it will be enforceable only by the parties, like any other contract.*[19]

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17. The Supreme Court noted in *Cannon* that in all but one case it "has never refused to imply a cause of action where the language of the statute explicitly conferred a right directly on a class of persons that included plaintiff in the case." 441 U. S. at 690 n. 13.

18. *See* National Sea Clammers Assoc. v. City of New York, *supra*, No. 79-1360 at 16-17, where this court held that there was a private federal cause of action under § 505(e) of the Federal Water Pollution Control Act.

19. Senate Report at 2 (emphasis added). *See also* House Report at 27.

After the indenture is qualified, the active role of SEC has been fulfilled and the plaintiff's remedy is to pursue his own action for breach of the indenture. As the Senate Report stated:

> The bill proceeds on the theory that the proper remedy is to correct these deficiencies in the trust indenture, and that the appropriate time to correct those deficiencies is before the bonds are offered in interstate commerce or through the mails. If this is done, it is believed *that the enforcement of the provisions of the indenture may appropriately be left to the bondholders themselves,* without continuing supervision by a governmental agency.[20]

Thus, the legislative history unequivocally advances the premise that the bondholders may bring a suit for breach of the indenture provisions. However, it does not specify the proper forum.

In *Transamerica Mortgage Advisors, Inc. v. Lewis, supra* — U. S. —, 48 U. S. L. W. 4001, the Court faced the analogous issue of whether a private federal right of action could be found under section 215 of the Investment Advisors Act, 15 U. S. C. § 80(b), where the legislative history also was silent as to the proper forum.[21] Section 215 provides that contracts whose formation or performance would violate the Investment Advisors Act "shall be

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20. Senate Report at 8 (emphasis added); *Morris, supra* 390 F. Supp. at 821. *See also* House Report at 26.

21. The Court also considered the issue of whether a private action exists under § 206 of the Investment Advisors Act, 15 U. S. C. § 80b-6, and concluded it does not because "§ 206 simply proscribes certain conduct, and does not in terms create or alter any civil liabilities," — U. S. at —, 48 U. S. L. W. at 4003.

void . . . as regards the rights of" the violator and knowing successors in interest.[22] The Court stated:

> In the case of § 215, we conclude that the statutory language itself fairly implies a right to specific and limited relief in a federal court. By declaring certain contracts void, § 215 by its terms necessarily contemplates that the issue of voidness under its criteria may be litigated somewhere.

—U. S. at —; 48 U. S. L. W. at 4003. The Court considered that Congress could have intended claims under section 215 to be raised only in state court but rejected the contention stating, "we decline to adopt such an anomalous construction *without some indication that Congress in fact wished to remit the litigation of a federal right to state courts.*" *Id.* at — n. 8; 48 U. S. L. W. at 4003 n. 8 (emphasis added). There was no legislative history showing that Congress sought to limit section 215 actions to state court so the court found a federal cause of action.

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22. Section 215, 15 U. S. C. § 80b-15, reads in part as follows:

§ 80b-15. Validity of contracts

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

From the above discussion there can be little question that the Trust Indenture Act allows for suits by debenture holders against the trustee for breach of the indenture. First Pennsylvania argues that such suits are limited to state, not federal, court. Under the holding of *Transamerica,* absent some indication that Congress intended to limit the litigation of the federally-created right to state court, the right is enforceable in federal court. We fail to find any such indication. To the contrary, the legislative history indicates that Congress sought to nationalize the issues of concern in the Act.[23] There is no indication whatsoever in any portion of the legislative history that Congress sought to restrict suits under the Act to state court.[24] Thus, we find that the second *Cort* factor points to the implication of a federal cause of action.

The third *Cort* factor asks us to determine whether a federal remedy is consistent with the overall structure of the Act. 422 U. S. at 84. In *Cannon* the Court noted that

> when [a private right of action] remedy is necessary or at least helpful to the accomplishment of the pur-

23. *See* Senate Report at 3; Hearings at 18, 31. For example, Commissioner Douglas at the House Hearings said "it is our conviction that there is only one way to deal with the problem and that is in a uniform way." Hearings at 31.

24. This court had occasion to examine the Act in In Re Pittsburgh & Lake Erie R. R. Securities and Antitrust Litigation, *supra* 543 F. 2d at 1058. The court, relying in part on the purposes of the Act, found that an indenture trustee had standing to contest settlement of a shareholders' derivative suit because "[a]ny other rule would be at variance with the evident intention of Congress, in passing the . . . Act . . . , to increase the protection of investors who depend upon the security which an indenture trustee holds in their interest." *Id.* at 1067. *See also Dropkin, supra,* n. 11 at 330-33.

pose, the Court is decidedly receptive to its implication under the statute.

441 U. S. at 703. There are several reasons why a finding of a federal cause of action is necessary and helpful to the purposes of the Act. First, the Act sought to attack a national problem in a uniform way.[25] Congress believed that the "inadequacy [of indentures] presents a national problem which cannot be dealt with effectively by the States. . . ."[26] A necessary means of facilitating the national uniformity goal of the Act would be through enforcement of the indenture in a federal forum. It is hard to believe that Congress would have established uniform standards to govern indentures and then paradoxically have allowed the application of those standards to depend on the law of the state of the suit.[27] The interpretation of the indenture provisions mandated by the Act does not depend on ordinary contract principles—the intent of the parties—but depends on an interpretation of the legislation. It would be contrary to the purposes of the Act to

25. See n. 23 *supra*. The dissent suggests that the Act intended to create uniform provisions in the indenture but not a uniform forum. We reject this view because it would be anomalous for Congress to mandate uniform provisions and then allow the interpretations of those provisions to vary with the choice of forum.

26. House Report at 25.

27. It is especially difficult to believe that Congress intended exclusive interpretation of indentures to be in state courts when it is realized that, at the time of the passage of the Act, 26 states had not had trusteeships under indentures filed with the SEC for the preceding two and one-half years. 84 Cong. Rec. 502 (remarks of Sen. Miller). Thus, 26 states would have had little or no experience in the intricacies of indenture agreements. The proposed Federal Securities Code provides in § 1004(c) that mandated indenture terms "shall be interpreted, applied, and enforced exclusively as a matter of federal law." *Dropkin, supra* n. 11.

have the trustee held to certain standards in one state court and potentially different standards in another. Thus, federal court jurisdiction is necessary to achieve the uniform standards intended by the Act.[28]

Second, federal court jurisdiction is necessary and helpful to enforcement of the Act because there is no federal administrative enforcement. The district court in this case declared:

> If we were to agree with First Pennsylvania that the indenture holders are relegated to state court, we would create the anomalous situation of having a federally mandated right which is not enforceable *in any federal forum*, regardless of the amount in controversy or the exhaustion of state remedies.

473 F. Supp. at 209 (emphasis supplied). Courts have indicated they are more willing to find a private cause of action where agency resources are limited. *See Abrahamson v. Fleschner*, 568 F. 2d 862, 872 (2d Cir. 1977), *cert. denied*, 436 U. S. 913 (1978).[29] In this case

28. Unless there is a federal cause of action it is unlikely the Supreme Court would have an opportunity to interpret the provisions of the Act. Thus, there could not be a resolution of conflicting state interpretations. *See generally* 28 U. S. C. § 1257.

29. In *Transamerica, supra*, — U. S. at —, 48 U. S. L. W. at 4003, one of the crucial reasons for denying a private cause of action under § 206 of the Investment Advisors Act was that Congress specifically provided for administrative enforcement. In *Cannon, supra*, 441 U. S. at 706-08 n. 41, the Court allowed a private right of action as helpful to the administrative scheme. The Court took note of the agency's support for a private cause of action. In this case the SEC, *amicus curiae*, supports a federal cause of action. In Rogers v. Frito-Lay, Inc., 611 F. 2d 1074, 1084 (5th Cir. 1980), the fifth circuit recently denied a private cause of action under § 503 of the Rehabilitation Act of 1973, 29 U. S. C. § 793, because private enforcement was difficult to harmonize with an administrative enforcement network.

the only enforcement of the Act would be in state courts if the federal courts do not entertain jurisdiction. Thus, we believe the lack of administrative enforcement makes federal jurisdiction necessary to effectuate the purposes of the Act.

Third, there is no indication in the legislative history that Congress was concerned with federal-state comity as it relates to the allocation of enforcement authority. Rather, the Act sought to apportion administrative and judicial authority. Therefore, the exercise of federal jurisdiction would not intrude on any congressionally recognized state authority and therefore is consistent with the Act.[30]

Fourth, the language of the jurisdictional section of the Act is fully consistent with the exercise of federal jurisdiction. The jurisdictional grant under section 322 gives federal and state courts concurrent jurisdiction over *all* liability "created" by the Act. To "create" means "to bring into existence; to make out of nothing and for the first time." Webster's Third New International Directory, Unabridged. The Congress "created" the terms of the indenture as they did not exist before. First Pennsylvania argues that the language in section 322 about "creating" liability deals only with the express, and not any implied,

30. First Pennsylvania argues that there is not federal court jurisdiction over suits for breach of the indenture because the Act expressly provides for civil and criminal liability in certain instances. See n. 4 and 5 *supra*. However, in *Cannon* the Court stated:

> The fact that other provisions of a complex statutory scheme create express remedies has not been accepted as a sufficient reason for refusing to imply an otherwise appropriate remedy under a separate section.

441 U. S. at 711.

liabilities of the Act, such as for misrepresentations in the filing documents. There is no support for this argument; the language of section 322 applies to "*any* liability created by this subchapter." (Emphasis supplied.)

The exercise of federal jurisdiction appears to be necessary to effectuate the purposes of the Act. At the very least, a federal cause of action is "helpful" to effectuate congressional intent.[31] Thus, the *Cort* factor points to the implication of a federal cause of action.

The final *Cort* factor turns on whether the matter is one which is traditionally relegated to state law. 422 U. S. at 84. First Pennsylvania argues that the complaint alleges nothing more than traditional state law causes of action sounding in negligence, breach of contract and breach of trust. It relies in part on *Sante Fe Industries, Inc. v. Green*, 430 U. S. 462 (1977), where the Court refused to create an implied cause of action under Rule 10b-5, 17 C. F. R. § 240.106-5, in favor of minority shareholders who were "frozen out" in a "short-form merger." The court reasoned that the regulation of fiduciary duties was a matter traditionally relegated to state law.

The *Cort* test of whether an area of law is traditionally regulated by the state does not preclude Congress from legislating in that area. Rather, the *Cort* test conveys the notion that courts should not assume Congress intended to regulate a previously state-controlled area. We do not believe that enforcement of the terms of an indenture mandated by the Act is a matter relegated to state law. It is unquestionable that Congress intended to legislate over trust indentures and deal with the problem on a national scale.

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31. In National Sea Clammers Ass'n v. City of New York, *supra*, this court found a private right of action where it would be "helpful" to the statutory purposes.

Furthermore, the issues in this case do not involve familiar principles of contract law. The interpretation of the mandated terms in the indenture agreement will not depend on the intent of the parties but on the meaning of the Act. The interpretation of agreements containing federally mandated provisions is not a matter relegated to state law.[32] The subject matter of this suit, the construction of a federal statute, is quite different than the traditional state concern for fiduciary duties found in *Sante Fe Industries*. Thus, this *Cort* factor also supports finding a federal cause of action.

There is no need to weigh the *Cort* factors where they all indicate that a federal cause of action exists under the Act. *Cannon*, 441 U. S. at 709. The plaintiffs are members of the protected class, congressional intent indicates the availability of a federal forum, a federal cause of action is consistent with the Act and federal jurisdiction would not intrude on a matter of state concern. The language, purpose, and legislative history of the Act all indicate a congressional intent to allow private victims to sue in federal court for breach of mandated indenture terms.[33]

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32. *See e.g.*, International Association of Machinists v. Central Airlines, Inc., *supra*, 372 U. S. 682.

33. First Pennsylvania argues that the latest Supreme Court securities cases, denying private rights of action, preclude such an action in this case. We believe the Trust Indenture Act is very different and that the recent cases are easily distinguishable.

In *Touche Ross*, *supra*, 442 U. S. at 560, the Court held there was no private action under section 17(a) of the 1934 Act. The issue concerned whether customers of brokerage firms have an implied cause of action against accountants who audit the reports for misstatements in the reports. There were many reasons why the private action was denied, including the following. First, the parties filed a state court action almost identical to the federal action except § 17(a) was not specified. Second, § 18(a) of the

V.

We hold that the Trust Indenture Act provides injured debenture holders with a federal cause of action for the breach of terms mandated by the Act. The judgment of the district court will be affirmed.

Costs taxed against appellant.

LAYTON, *District Judge,* dissenting.

I agree with the majority that no federal cause of action exists based upon the meaning of the word "create"

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33. (Cont'd.)

1934 Act created an express remedy, with a reliance requirement, for the same activities sought to be covered by § 17(a). Third, § 17(a) does not confer rights or proscribe conduct. Fourth, the intent of § 17(a) was evident from its face—a recordkeeping provision. Fifth, § 17(a) protects investors by providing an early warning system to the SEC to take appropriate action to forestall insolvency. Sixth, the legislative history of § 17(a) was silent and the plain language weighed against implication of a private remedy.

In *Transamerica,* — U. S. at —, 48 U. S. L. W. at 4001, after finding an implied right of action under § 215, the Court held there was no such right under § 206 of the Investment Advisors Act. The issue concerned whether there was a derivative cause of action on behalf of a trust against the trustees, the trust's investment advisor and two corporations affiliated with the latter. The Court denied the action for damages for the following reasons. First, the claim was similar to a claim of breach of fiduciary duties, held not to support an implied cause of action in Sante Fe Industries, Inc. v. Green, *supra,* 430 U. S. at 462. Second, the SEC was specifically granted enforcement duties under § 209 of the Act, the only enforcement provision. Third, Congress expressly provided judicial and administrative mechanisms for enforcing compliance with the Act. Fourth, the legislative history expressly showed an intent not to create a private right of action.

Our earlier discussion manifested that none of the reasons for denying a private cause of action in *Touche Ross* and *Transamerica* are present in this case. The statutory scheme at issue here unmistakably allows for federal jurisdiction over private causes of action.

in Sec. 322 of the Act here under consideration. However, I respectfully dissent from the opinion of the majority, concluding that a private right of action may be implied.

One of the basic questions is the effect of *Touche Ross* upon *Cort*. Does it not, essentially, render Congressional intent the sole criterion for implying a private cause of action?

Nor am I persuaded by the reliance of the majority on *Transamerica Mortgage Advisors, Inc.* as authority for the proposition that a private cause of action can be implied under the language of this Act. That case involved an unusual provision in the Investment Advisors Act, not at all analogous to this case, wherein Congress created a right of action on behalf of investors wherein certain types of contracts might be declared void. The majority, relying on this provision and citing certain language of Commissioner Douglas during the Committee hearings,* reached the conclusion that a private right of action was intended.

I am unable to agree. Not only, as just stated, was the provision of the Act declaring certain types of contracts void completely foreign to the provisions of the Act here under consideration but, with deference, I submit that the circumstantial evidence to be gleaned from the Committee hearings preceding the passage of this Act

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* The majority has cited testimony before Congress by Commissioner Douglas indicating that the Act aimed at dealing with the problem "in a uniform way". Slip op. at 16 n. 23. In view of the structure of the Act, however, I think it likely that Commissioner Douglas was stressing the importance of creating uniform provisions in the *indenture*, not a uniform *forum*. The Act, by its terms, requires certain uniformity among the contracts governing debentures. Indeed, certain legislative history quoted by the majority supports the proposition that the focus of the Act is the content of the indenture. *See* slip op. at 14.

points more strongly to an intention on the part of Congress to use the state, not federal, courts for a remedy. In this connection, I quote from an article in the Tulane Law Review by Charles E. Dropkin, entitled *Implied Civil Liability Under the Trust Indenture Act.* The language concerns not only the Act under consideration, but certain other language of Commissioner Douglas at the same hearings.

> When Congress enacted this key section, it intended *neither to allow bondholders resort to a federal forum* nor to federalize the prudent man concept. It simply sought to mandate that a particular private contract, namely the indenture, should now contain a provision establishing the appropriate standard of trustee conduct during default administration. As Commissioner Douglas testified: 'The indenture, after it has been 'qualified' under this statute, will be enforceable, in the same manner as any other contract is enforceable, in the same manner that indentures *presently* executed are enforceable'. An indenture is nothing more than a private contract and should be treated as such. *Since ordinary contract disputes are resolved in state courts under state law, so also should indenture disputes continue to be settled.*

52 Tul. L. Rev. 299, 323 (1978) (My emphasis).

This conclusion is strongly fortified by placing the testimony of Commissioner Douglas, and particularly his use of the word "presently", in the context of the time of these Congressional hearings, which was 1938, over forty years ago. Unlike the present, there was then no controversy in the courts as to the proper forum in which

indenture abuses should be resorted to. Legal thinking simply assumed that the state courts were the proper forum and an examination of a number of cases seems to fortify this conclusion. *E.g.* Gouley v. Land Title Bank & Trust Co., 329 Pa. 465, 198 A. 7 (1938); Fleener v. Omaha Nat's Co., 131 Neb. 253, 267 N. W. 462 (1936); Newhall v. Norristown Trust Co., 280 Pa. 195, 124 A. 337 (1924).

For these reasons, I feel that the conclusion of the majority as to the existence of Congressional intent is quite inconclusive. However, even if we employ the remaining *Cort* considerations as a means of inferring the presence of such intent, the result is, at best, ambiguous. Although plaintiffs here are of the class for whose benefit the statute was passed, and it is consistent with the legislative intent to imply a right of action in plaintiffs, the remedy is traditionally a matter of state law.

Under these circumstances, and in the light of the apparent intention of the Supreme Court to limit sharply the doctrine of implication, *see Touche Ross & Co. v. Redington, supra,* I would hold that no federal cause of action is implied under this Act.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-3294

JAY A. ZEFFIRO, Individually and on behalf of all other persons similarly situated

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY

AND

CIVIL ACTION NO. 78-4316

HARRY M. BERNARD, JR., on behalf of himself and all others similarly situated

v.

FIRST PENNSYLVANIA BANK, N. A., and CAPITAL FIRST CORPORATION

MEMORANDUM AND ORDER.

[Entered June 29, 1979]

BECHTLE, *J.* JUNE 28, 1979

Presently before the Court are the motions of the defendant First Pennsylvania Bank, N. A.[1] ("First Pennsylvania"), to dismiss for lack of subject matter jurisdiction, pursuant to Fed. R. Civ. P. 12(b)(1), and to

1. In the Zeffiro action, the defendant is stated to be "First Pennsylvania Banking and Trust Company." This is a predecessor of "First Pennsylvania Bank, N. A.," and this error is not urged as a ground for dismissal by First Pennsylvania Bank, N. A.

dismiss for failure to state a claim upon which relief can be granted, pursuant to Fed. R. Civ. P. 12(b)(6). For the reasons stated below, the motions will be denied.

FACTUAL BACKGROUND

In 1972, Capital Equipment Leasing Corporation, a predecessor of defendant Capital First Corporation ("Capital"), issued $1,500,000 principal amount, 9% subordinated debentures with a maturity date of May 31, 1982 ("the debentures"). The debentures were issued under a trust indenture which named First Pennsylvania Banking and Trust Company, a predecessor of First Pennsylvania, as indenture trustee. It is alleged that the debenture issue was subject to the qualification requirements of the Trust Indenture Act of 1939 ("the Act"), 15 U. S. C. §§ 77aaa-77bbbb, and the Court will assume, for the purpose of the instant motions, that the issue was so qualified. Pursuant to the requirements of the Act, the indenture contained numerous provisions detailing the duties of First Pennsylvania toward the debenture holders. In December of 1976, Capital defaulted on its obligations to pay interest on the debentures and, subsequently, filed a petition under Chapter XI of the Bankruptcy Act on December 19, 1978.

On September 29, 1978, plaintiff Jay Zeffiro ("Zeffiro") filed a class action complaint against First Pennsylvania, alleging jurisdiction under § 322 of the Act, 15 U. S. C. § 77vvv(b), which incorporates by reference the concurrent jurisdictional section of the Securities Act of 1933. *See* 15 U. S. C. § 77v(a). Zeffiro, as an owner of the debentures in the amount of $5,000, seeks to represent all persons who at any time owned any of Capital's 9% subordinated debentures due in 1982. Zeffiro alleges that: (1) First Pennsylvania violated § 311 of the Act, 15

U. S. C. § 77kkk, and § 6-13 of the indenture by failing to account to the debenture holders for certain funds it received from Capital as part of a separate and subsequent loan transaction; (2) First Pennsylvania violated § 313 of the Act, 15 U. S. C. § 77mmm, and § 7-13 of the indenture because, even if such an account was created, the debenture holders were not notified of such action; (3) First Pennsylvania breached its contractual and fiduciary obligations by its failure to obtain certain security for the benefit of the debenture holders; and, (4) First Pennsylvania breached a confidential trust and was negligent.

On December 27, 1978, plaintiff Harry M. Bernard [2] ("Bernard") filed a class action complaint against First Pennsylvania and Capital, alleging jurisdiction under the Act [3] and invoking the pendent jurisdiction of the Court. In addition to various claims against Capital which are not relevant here, Bernard, as owner of debentures in the amount of $12,000, alleges that First Pennsylvania violated the Act and the indenture by its failure to provide certain notifications and reports to the debenture holders' benefit.

On January 5, 1979, the Court ordered the consolidation of the Zeffiro and Bernard actions for all purposes, pursuant to Fed. R. Civ. P. 41. Pursuant to the provisions of the Bankruptcy Act, all proceedings are stayed against Capital, absent permission to proceed from the bankruptcy court.

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2. Isabella G. Smith was an additional plaintiff in the Bernard action, but was voluntarily dismissed, pursuant to Fed. R. Civ. P. 41(a) and 23(e), by Order of Court on March 13, 1979.

3. Bernard also alleged jurisdiction under the National Bank Act, 12 U. S. C. § 2(a). Counsel has not addressed the issue of whether this section vests this Court with jurisdiction and, in light of our conclusion that this Court does have jurisdiction under the Trust Indenture Act, we need not address the National Bank Act.

First Pennsylvania acknowledges that the debenture holders may allege common law causes of action for breach of trust and breach of contract, but contends that the Act does not expressly provide for a federal cause of action or for federal jurisdiction and that, therefore, the debenture holders' suit must be brought in state court. In the alternative, First Pennsylvania argues that the action is barred by the one-year period of limitation established by the Act for the bringing of suits to establish liability under its express liability section. *See* § 323, 15 U. S. C. § 77www.

The debenture holders contend that, whereas the Act does not expressly provide a cause of action in their favor, the Court should imply a federal remedy because the Act "creates" liability in that it mandates the terms of the indenture. Secondly, they argue that the one-year period of limitation urged by First Pennsylvania applies, by its very terms, only to suits brought for false and misleading statements in documents filed with the Securities and Exchange Commission ("SEC"), and that the Court must look to state law for the analogous period of limitation.

IMPLIED CAUSE OF ACTION

We are squarely presented with the question of whether there is a federal cause of action in favor of debenture holders against a trustee for breach of the provisions of an indenture, when those provisions are governed by the Trust Indenture Act. Although it is clear that debenture holders would have a cause of action for breach of trust cognizable in state court, we must determine whether such an action is within the jurisdictional grant of the Act. Although the Act has been in existence for many years, this question has only been addressed on several occasions. In *Caplin v. Marine Midland Grace Trust Co.*, 406 U. S. 416 (1972), the Supreme Court assumed

arguendo that bond holders could allege a federal cause of action against a trustee, *Id.*, at 426 n. 17, 433 n. 23, but held that the defaulting issuer's trustee in bankruptcy did not have standing under the Bankruptcy Act to assert those claims. *Id.*, at 434. *See also Caplin v. Marine Midland Grace Trust Co.*, 439 F. 2d 118, 123 n. 5 (2d Cir. 1971).

The first case to hold that debenture holders could allege a federal cause of action was *Morris v. Cantor*, 390 F. Supp. 817 (S. D. N. Y. 1975). The *Morris* court noted that the legislative history of the Act indicated that Congress was concerned with serious abuses of the trust indenture as an instrument of corporate finance, *Id.*, at 820, and was cognizant of the national scope of the problem. *Id.*, at 822. The court concluded by stating:

> [T]his legislation must be viewed as an indirect method of imposing nationally uniform and clearly defined obligations upon those associated with the issuance of corporate debt. The Court holds that the statute thereby "created liability" as surely as though it had directly required the same actions and standards of behavior of trustees and obligors. . . .

Id. The court, therefore, held that the Trust Indenture Act vested federal courts with jurisdiction to enforce the terms of trust indentures. *Id.*, at 833.

The *Morris v. Cantor* holding was followed without discussion in *In re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161 (C. D. Cal. 1976). *See also Lewis v. Marine Midland Grace Trust Co.*, 63 F. R. D. 39 (S. D. N. Y. 1973). However, subsequent developments in the law in terms of the creation of implied causes of action convince us that the *Morris v. Cantor* holding must be reexamined. *Clark v. Gulf Oil Corp.*, 570

F. 2d 1138, 1148 (3d Cir. 1977), *cert. denied*, 435 U. S. 970 (1978).

In *Cort v. Ash*, 422 U. S. 66 (1975), the Supreme Court articulated four factors to be considered when a court is asked to imply a cause of action:

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Id., at 78 (citations omitted). The Court notes that a private remedy will not be implied in the context of every federal statute, *Polansky v. Trans World Airlines, Inc.*, 523 F. 2d 332 (3d Cir. 1975); *Rauch v. United Instruments, Inc.*, 548 F. 2d 452, 456 (3d Cir. 1976); *Wolf v. Trans World Airlines, Inc.*, 544 F. 2d 134 (3d Cir. 1976), and that *Cort* has been characterized as having "severely limited the circumstances in which a federal court may imply a private cause of action from a federal statute." *Chrysler Corp. v. Schlesinger*, 565 F. 2d 1172, 1188 (3d Cir. 1977).

TRUST INDENTURE ACT

A study was conducted in 1936 by the SEC, pursuant to a statutory mandate, 15 U. S. C. § 78ji, which revealed widespread abuses in the issuance of corporate bonds

under indentures.[4] *See* Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part IV, Trustees Under Indentures (1937) ("SEC Report"). The report made it clear that indenture trustees frequently did not represent the interests of the debenture holders but were more closely identified with the issuer and were protected by broad exculpatory clauses in the indenture. SEC Report at 2-9, 68-70. The debenture holders were often widely scattered and had difficulty enforcing their rights under indentures. SEC Report at 5-6. Furthermore, courts often enforced indenture terms as written rather than applying the traditional standards of fiduciary duty. *Id.*

The problem was seen as being national in scope in light of the large volume of debt securities traded on national exchanges. *See* Senate Committee on Banking and Currency, Report on the Trust Indenture Act of 1939, S. Rep. No. 248, 76th Cong., 1st Sess. 3-4 (1939) ("Senate Report"); H. R. Rep. No. 1016, 76th Cong., 1st Sess. 25 (1939) ("House Report"). Although it was clear that a nationwide solution, which would establish clearly defined obligations, was needed, there was concern that additional federal intrusions into capital markets would be dangerous at a time when the Nation needed to revitalize those markets. Hearings on H. R. 10292 Before a Subcommittee of the Committee on Interstate and Foreign Commerce, 75th Cong., 3rd Sess. 31-32 (1938) (statement of SEC Commissioner Douglas) ("House Hearings"). Furthermore, there was vigorous opposition by banking institutions to additional regulation of business, *Morris v. Cantor, supra,*

4. For a summary of abuses, *see* Hearings on H. R. 10292 Before a Subcommittee of the Committee on Interstate and Foreign Commerce, 75th Cong., 3rd Sess. 20 (1938) (summary submitted by Commissioner Douglas).

390 F. Supp. at 821, and there was concern that the SEC might become involved in the purely business aspects of bond issues. 84 Cong. Rec. 5013-14 (1939) (remarks of Sen. Taft); House Hearings at 19 (statement of Commissioner Douglas).

There were various methods by which Congress could have attempted to solve the problems outlined in the SEC Report. House Hearings at 34. Rather than statutorily standardize the trustee's behavior directly, *Id.*, the Act established the standard of behavior indirectly by refashioning the indenture itself. SEC Report at 6.

The structure of the Act is as follows: Before debt securities not exempted from the Act may be offered to the public, the indenture under which they are issued must be "qualified" by the SEC. With respect to securities subject to the registration requirements of the 1933 Act, the indenture is deemed "qualified" when registration becomes effective. § 309, 15 U. S. C. § 77iii. The SEC will permit the registration to become effective if it finds, *inter alia*, that: (1) the security has been issued under an indenture; (2) that the person designated as trustee is eligible to so serve, § 305, 15 U. S. C. § 77eee(b); and, (3) the indenture conforms to the requirements of §§ 310 through 318, 15 U. S. C. §§ 77jjj-77rrr.

With respect to securities not required to be registered under the 1933 Act, the indenture will be deemed "qualified" once the SEC permits the "application for qualification" to become effective. § 309(a)(2), 15 U. S. C. § 77iii(a)(2). In any event, the indenture must conform to the requirements of §§ 310 through 318.

Sections 310 through 318 form the core of the Act in that they outline the substantive duties that the indenture must impose on the trustee. These sections are of three types. The first type is proscriptive in nature, prohibiting certain terms. For example, § 315, 15 U. S. C. § 77ooo(d),

prohibits provisions in the indenture which would relieve or exculpate the trustee from liability for negligence. The second type of section is merely permissive in nature. An example of this type of section is § 315(a), 15 U. S. C. § 77ooo(a)(1), which states that the indenture *may* contain a provision relieving the trustee of liability except for the performance of such duties as are specifically set out in such indenture.

The third type of section, and the most important for our purposes, is mandatory and prescriptive in nature. These sections begin with the phrase "the indenture to be qualified *shall* provide" or "shall require." An example of this type of section is § 311, 15 U. S. C. § 77kkk, which states that the indenture *shall* require the trustee to establish certain accounts for the benefit of bond holders in the event the trustee also becomes a creditor of the issuer and the issuer defaults on the bonds.

Once the registration becomes effective, the SEC has no enforcement authority and cannot issue a stop order for a violation of the indenture provisions by a trustee, § 309, 15 U. S. C. § 77iii(e), but is limited to exercises of general rulemaking and investigatory authority. 15 U. S. C. §§ 77ddd(c), (d), (e); 77eee(a), (c); 77ggg; 77sss; 77ttt. Moreover, the only express civil liability[5]

5. Section 324 states:

> It shall be *unlawful* for any person in offering, selling or issuing any security to represent or imply in any manner whatsoever that any action or failure to act by the Commission in the administration of this subchapter means that the Commission has in any way passed upon the merits of, or given approval to, any trustee, indenture or security, or any transaction or transactions therein, or that any such action or failure to act with regard to any statement or report filed with or examined by the Commission pursuant to this subchapter or any rule, regulation, or order thereunder, has the effect of a finding by

established by the Act is found in § 323, which states in part:

> (a) Any person who shall make or cause to be made *any statement in any application, report, or document filed with the Commission* pursuant to any provisions of this subchapter, or any rule, regulation, or order thereunder, which statement was at the time and in the light of the circumstances under which *it was made false or misleading with respect to any material fact,* or who shall omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall be liable to any person (not knowing that such statement was false or misleading or of such omission) who, in reliance upon such statement or omission, shall have purchased or sold a security issued under the indenture to which such application, report, or document relates, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading or of such omission.

15 U. S. C. § 77www (emphasis added). The Act does, however, provide for criminal liability for certain willful violations and misrepresentations. § 325, 15 U. S. C. § 77yyy.[6]

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5. (Cont'd.)

the Commission that such statement or report is true and accurate on its face or that it is not false or misleading.

15 U. S. C. § 77xxx (emphasis added). While this section does contain a prohibition, it does not expressly provide for criminal or civil liability and is not directly relevant.

6. Section 325 states:

> Any person who willfully violates any provision of this subchapter or any rule, regulation, or order thereunder, or any

The general jurisdictional grant of the Act is found in § 322, which states:

> (b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to enforce *any liability created by, this subchapter,* or any rules or regulations or orders prescribed under the authority thereof, shall be as provided in section 77v(a) of this title.

15 U. S. C. § 77vvv(b) (emphasis added). Incorporated, by reference, is the jurisdictional section of the Securities Act of 1933, 15 U. S. C. § 77v(a), which provides for concurrent jurisdiction in state and federal court for all suits in equity and actions at law.[7]

The debenture holders contend that this Court has jurisdiction over their claims because they are relying on provisions mandated by the Act. Therefore, they are seek-

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6. (Cont'd.)

person who willfully, in any application, report, or document filed or required to be filed under the provisions of this subchapter or any rule, regulation, or order thereunder, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

15 U. S. C. § 77yyy.

7. 15 U. S. C. § 77v(a) states, in pertinent part:

> (a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, *and, concurrent with State and Territorial courts,* of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. . . .

(Emphasis added.)

ing to enforce "liability created by" the Act within the meaning of § 322. First Pennsylvania argues in response that there is no express provision for a federal cause of action and that we should not create an implied remedy because Congress intended that, absent diversity of citizenship, enforcement suits be brought in state court. We note that this is not a statute which is primarily criminal in nature or one that is manifestly designed to protect the public in general. Rather, it is clear that the rights of debenture holders are articulated in the Act. The question before us is whether these rights give rise to liability "created" by the Act within the meaning of the jurisdictional grant. While this would seem to be a question of pure statutory interpretation—*i.e.*, defining the word "created" as used in the jurisdictional grant—the parties urge the Court to employ the *Cort v. Ash* implied-cause-of-action analysis. The Court will employ this implied-cause-of-action analysis, despite its doubts about its complete applicability, because the *Cort v. Ash* analysis is comprehensive and includes, by necessity, an examination of the statute's structure.[8]

The threshold question under *Cort* is whether the Trust Indenture Act was enacted for the benefit of a special class of which the debenture holders are members. *Id.*, at 80-82. An examination of the statutory language, 15 U. S. C. § 77bbb(a)(1)-(6), and an analysis of the relevant legislative history, Senate Report, at 1-6; House

8. The *Morris v. Cantor* court apparently did not consider this issue to be one of an implied remedy, because it did not cite or rely on any cases preceding *Cort v. Ash*. The *Morris* court simply determined that liability was "created" by the Act for violation of the indenture within the meaning of the jurisdictional grant. While we agree with that court's conclusion and approve of its analysis, this Court will apply the broader *Cort* analysis at the urging of the parties.

Report at 25, make it clear that Congress sought to protect debenture holders from breaches of fiduciary duty by trustees in the performance of their duties under an indenture. This goal was noted in *In re Pittsburgh & Lake Erie Railroad Co. Securities & Antitrust Litigation*, 543 F. 2d 1058 (3d Cir. 1976), when the court stated:

> . . . the evident intention of Congress, in passing the Trust Indenture Act, 15 U. S. C. § 77aaa et seq., [was] to increase the protection of investors who depend upon the security which an indenture trustee holds in their interest. . . .

Id., at 1067. *See also In re Multiponics, Inc.*, 436 F. Supp. 1972, 1075 (E. D. La. 1976).

Moreover, we find that the harm allegedly incurred by the debenture holders is the harm Congress sought to avoid, *Rauch v. United Instruments, Inc., supra*, 548 F. 2d at 457-458, and that private enforcement suits are the intended means of enforcement. Senate Report at 2. This is to be contrasted with statutes construed to be for the benefit of the public at large, *Cort v. Ash, supra*, 422 U. S. at 82, and with statutes that are primarily criminal in nature. *Kroungold v. Triester*, 407 F. Supp. 414 (E. D. Pa. 1975). *See also Cannon v. University of Chicago*, 47 U. S. L. W. 4549, 4552 n. 13 (1979).

While we recognize that our determination that the debenture holders are members of the class which Congress sought to benefit is not of itself determinative, *Clark v. Gulf Oil, supra*, 570 F. 2d at 1146; *Sears, Roebuck & Co. v. Eckard*, 575 F. 2d 1197, 1203 n. 16 (7th Cir. 1978), the first of the four factors articulated in *Cort* clearly favors the implication of a federal remedy.

The second prong of the *Cort* analysis requires a consideration of the relevant legislative history to discern

an intent to grant or deny a federal cause of action. *Cort v. Ash, supra,* 422 U. S. at 82. We must recognize that the legislative history of a statute which does not expressly grant a private remedy will often be "equally silent or ambiguous on the question." *Cannon v. University of Chicago, supra,* 47 U. S. L. W. at 4553. Therefore, while a clear indication of an intention to deny will be determinative, where it is clear that the plaintiffs are members of the class to be benefited, an expression of congressional intent to create a remedy will not be required. *Id.*

First Pennsylvania argues that the Act was designed to minimize all federal involvement in the enforcement process and that the legislative history evidences an intent to deny a federal remedy. The debenture holders argue, in response, that the legislative history evidences an intent to limit federal administrative involvement and that Congress intended to provide a federal *judicial* enforcement procedure.

First Pennsylvania cites the testimony of Commissioner Douglas before a subcommittee of the Committee on Interstate & Foreign Commerce:

> Nor does this bill give the Commissioner any power with respect to the enforcement of the provisions in these indentures. Under this bill, if it were the law, the Commission would be concerned only with those provisions which relate to the protection and enforcement of the rights of bondholders. *Once an indenture has been determined by the Commission to conform to the standards of the statute, the work of the Commission will have been completed.* After that date the Commission has no continuing jurisdiction over the corporate trustee; no continuing jurisdiction to take steps in connection with the enforcement of the various covenants in the inden-

> ture. *The indenture, after it has been "qualified" under this statute, will be enforceable in the same manner as any other contract is enforceable, in the same manner that indentures presently executed are enforceable.*

House Hearings at 22 (emphasis added). This principle is echoed in the Senate Report, which states:

> The Commission's work will be completed when the form of indenture has been qualified under the bill . . . The Commission will have no powers with respect to the enforcement of the provisions of the indenture. *After the indenture has been executed it will be enforceable only by the parties, like any other contract.*

Senate Report at 2 (emphasis added). The Court does not agree that the legislative history evidences an intent to limit all federal involvement in the enforcement process but, rather, shows that Congress was concerned with federal *administrative* authority. During the House hearings, immediately preceding the testimony quoted by First Pennsylvania, Commissioner Douglas stated:

> *Now, this bill does not give the Commission any jurisdiction whatsoever over such matters as the wisdom of the issue or the amount of security* to be mortgaged or pledged under the bonds, or the offering price, or the maturity date, or the interest rate, or the sinking-fund provisions. In other words, the Commission is not, under this bill, given power to pass upon the investment merits of particular securities. That is not the theory of it.

House Hearings at 22 (emphasis added). Thus, it is clear that the Commissioner was addressing the issue of mini-

mizing SEC jurisdiction, not judicial jurisdiction. SEC interference was a major concern to Congress and to those associated with the capital market. As the *Morris* court pointed out:

> Banking institutions which frequently acted as trustees registered vigorous opposition to further regulation of business under what they called the "dominion theory." They viewed the Commission as a new agency seeking to expand its regulatory role and increasingly to encroach upon private business, and the registration procedures as so time consuming and costly that necessary financing would cease to be available.

Morris v. Cantor, supra, 390 F. Supp. at 821. *See also* House Report at 25-27. We conclude that there is no expression of congressional intent to deny a federal remedy. On the other hand, while it is clear that Congress intended that private suits be the primary enforcement mechanism, there is no clear expression in the legislative history of an intent to grant a federal forum.

Third, under *Cort,* we must determine whether a federal remedy is consistent with the overall structure of the Act. We note that a remedy should not be implied if it would frustrate the underlying purpose of the legislative scheme, *Cannon v. University of Chicago, supra,* 47 U. S. L. W. at 4555, but that "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Cort v. Ash, supra,* 422 U. S. at 84, *quoting J. I. Case Co. v. Borak,* 377 U. S. at 433. With these principles in mind, we find that a federal cause of action is entirely consistent with the structure of the Act and that such an implication is necessary to effectuate congressional goals. We rely on four factors.

First, we rely on the nature of the jurisdictional grant itself. We note that this Court is vested with jurisdiction to enforce any liability "created" by the Act and, in the absence of a statutory definition, we must rely on the plain meaning of the word. To "create" is defined as "to bring into existence; to make out of nothing and for the first time." Webster's Third New International Dictionary, Unabridged. With this definition in mind, we find that the Act "creates" liability for breach of the terms of an indenture in that those terms exist only because they are required by the Act. We find it manifestly clear that Congress "brought those terms into existence" and do not find it relevant that the liability is "indirectly" created by way of a contract claim. Furthermore, the grant of jurisdiction extends to liability created by "this subchapter" (the Act) and is not limited to the express civil liability provision of the Act. Section 322 also incorporates by reference the grant of concurrent jurisdiction to state and federal courts found in the Securities Act of 1933. A grant of concurrent jurisdiction is consistent with our finding that liability is created by the Act and does not support First Pennsylvania's contention that the debenture holders be relegated to state court.

Second, we place great emphasis on the lack of enforcement authority vested in the SEC. We are more willing to find a private remedy in the absence of a federal administrative enforcement provision. *Abrahamson v. Fleschner,* 568 F. 2d 862, 872 (2d Cir. 1977), *cert. denied,* 436 U. S. 913 (1978). If we were to agree with First Pennsylvania that the debenture holders are relegated to state court, we would create the anomalous situation of having a federally mandated right which is not enforceable in any federal forum, regardless of the amount in controversy or the exhaustion of state remedies.

Third, there is no indication that Congress was concerned with federal/state comity as it relates to the allocation of enforcement authority. Rather, the unique structure of the Act was a result of congressional concern with the allocation of judicial and administrative jurisdiction.

Fourth, we find that the goal of imposing a nationally uniform solution, which establishes uniform and clearly defined obligations, is best achieved by providing a federal forum. A federal forum would avoid complex choice-of-law problems and would provide a guiding force in the evolution of the law as it relates to trustees' obligations under trust indentures.

Fifth, the final inquiry suggested by *Cort* is whether implying a federal remedy is inappropriate because the subject matter involves an area traditionally of concern to the states. *Cannon v. University of Chicago, supra,* 47 U. S. L. W. at 4557. While we would agree that trust agreements have, in general, been the concern of the states, this is not the end of the analysis. As the court stated in *Polansky v. Trans World Airlines, Inc., supra:*

> Within the terms of the *fourth Cort* test, it would be entirely appropriate to relegate these appellants to whatever remedy has been created by state law. As the premise of this discussion, we recognize that a state remedy for breach of contract, breach of warranty and fraudulent misrepresentation was and, perhaps still is, readily available. *Only where there is some countervailing national interest should the federal courts imply a federal private remedy when an adequate state remedy already exists.*

523 F. 2d at 337 (emphasis added). In the case of "qualified" trust indentures, we find that Congress has acted on the need for a uniform national solution; and so

we find that there is a countervailing national interest in not relegating debenture holders to state court. Furthermore, while securities issues are, in general, subject to heavy federal regulation, issues under trust indentures are subject to intense and comprehensive federal regulation going to the relationships between the parties. We conclude that, even if the subject matter of the instant dispute was primarily of concern to the states, the Trust Indenture Act changed that.

First Pennsylvania contends that the holdings of *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462 (1977) and *Piper v. Chris-Craft Industries, Inc.*, 430 U. S. 1 (1977), militate against the finding of a federal remedy. While we agree that *Piper* and *Santa Fe Industries* may indicate a trend away from the creation of comprehensive private causes of action, especially in the securities area, each statute must be analyzed in the context of its own legislative facts. We note, therefore, that in *Piper* the Supreme Court refused to create a remedy in favor of an unsuccessful tender offeror under § 14 of the Securities Exchange Act, 15 U. S. C. § 78n(e). However, the Court found that the resolution of all four *Cort* factors militated against the creation of a remedy. *Piper v. Chris-Craft Industries, supra*, 430 U. S. at 37-41. Similarly, in *Santa Fe Industries*, the Court refused to create an implied cause of action under Rule 10b-5, 17 C. F. R. § 240.10b-5, in favor of minority shareholders who were "frozen out" in a "short-form merger." The Court held that the plain meaning of the statute and regulation in question foreclosed the creation of a remedy. *Santa Fe Industries, supra*, 430 U. S. at 477. Secondly, following the third prong of the *Cort* analysis, the Court held that creating a remedy would not effectuate the primary congressional goal but would interfere with an area traditionally reserved by the states. *Id.*, at 474-480. On the other hand, after our

analysis of the Trust Indenture Act, we find that a federal remedy is entirely consistent with the structure of the Act. Accordingly, we hold that the debenture holders have stated a claim and that this Court is vested with jurisdiction.

STATUTE OF LIMITATIONS

First Pennsylvania argues that, even if this Court has jurisdiction over an implied cause of action in favor of debenture holders against a trustee, the suit by the debenture holders in this case is barred by the applicable statute of limitations. First Pennsylvania urges this Court to apply the one-year period of limitation established by § 323 of the Trust Indenture Act, which states, in pertinent part:

> . . . No action shall be maintained to enforce any liability created under *this section* unless brought within one year after discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

15 U. S. C. § 77www(a) (emphasis added). In response, the debenture holders argue that the one-year period of limitation established by § 323 applies by its very terms to the express liability created by the Trust Indenture Act for false and misleading statements contained in documents filed with the SEC and that, therefore, this Court should apply the analogous period of limitation from state law.

We agree that, by its very terms, § 323(a) only applies to actions enforcing liability for false and misleading statements in documents filed with the SEC. We note that the language relied upon by First Pennsylvania is limited to actions brought to enforce liability "created under *this*

section," while the general jurisdictional section relied upon by the debenture holders vests jurisdiction in this Court over actions brought to enforce "any liability created by *this subchapter.*" § 322(b), 15 U. S. C. § 77vvv (b). In light of the plain meaning of the language employed by the draftsmen, we conclude that the one-year period of limitation does not apply to suits against trustees for breach of the indenture. First Pennsylvania refers the Court to *Lewis v. Marine Midland Grace Trust Co.,* 63 F. R. D. 39 (S. D. N. Y. 1973), in support of its contention that the one-year period of limitation is applicable. In a decision permitting the plaintiff to amend his complaint to allege causes of action under the Trust Indenture Act, the *Lewis* court outlined the factual allegations and concluded that the one-year limitation had been satisfied. *Id.,* at 51. However, *Lewis* is distinguishable on two grounds. First, the plaintiff in *Lewis* did allege a cause of action under § 323 for false statements in documents filed with the SEC. *Id.,* n. 27. Second, the *Lewis* court simply held that the shortest period of limitation had been satisfied, thus obviating the need to decide which was applicable to what claims.

In the absence of a congressionally mandated period, we must look to the analogous state law. *Ernst & Ernst v. Hochfelder,* 425 U. S. 185, 210 n. 29 (1976). We note that the debenture holders' allegations do not sound in fraud but are based on theories of breach of contract and breach of express trust. Consequently, we will apply the six-year period of limitation established in Pennsylvania by 42 Pa. C. S. A. § 5527(2), which states, in pertinent part:

> The following actions and proceedings must be commenced within six years:
>
> • • •

> (2) An action upon a contract, obligation or liability founded upon a bond, note or other instrument in writing, except an action subject to another limitation specified in this subchapter.

The debenture holders in the cases at bar brought suit in September and December of 1978. The indenture was entered into on May 15, 1972, and default did not occur until December, 1976. We conclude that the debenture holders' suit is not time barred.

An appropriate Order will be entered.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-3294

JAY A. ZEFFIRO, Individually and on Behalf of All Other Persons Similarly Situated

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY

AND

CIVIL ACTION NO. 78-4316

HARRY M. BERNARD, JR., on Behalf of Himself and All Others Similarly Situated

v.

FIRST PENNSYLVANIA BANK, N. A., and CAPITAL FIRST CORPORATION

ORDER.

AND NOW, TO WIT, this 28th day of June, 1979, IT IS ORDERED as follows:

1. The motion of defendant First Pennsylvania Bank, N. A. ("First Pennsylvania"), to dismiss for lack of jurisdiction over the subject matter, pursuant to Fed. R. Civ. P. 12(b)(1), is hereby *denied.*

2. The motion of defendant First Pennsylvania to dismiss for failure to state a claim upon which relief can be granted, pursuant to Fed. R. Civ. P. 12(b)(6), is hereby *denied.*

/s/ LOUIS C. BECHTLE, *J.*
Louis C. Bechtle, *J.*

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-3294

JAY A. ZEFFIRO, et al.

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY

CIVIL ACTION NO. 78-4316

HARRY M. BERNARD, JR., et al.

v.

FIRST PENNSYLVANIA BANK, N. A. and CAPITAL FIRST CORPORATION

ORDER.

[Entered July 31, 1979]

Defendant First Pennsylvania Bank, N. A. having moved for an order certifying this Court's Order of June 28, 1979, for interlocutory appeal pursuant to 28 U. S. C. § 1292(b), and the Court having considered the memoranda of law in support of and in opposition to the motion, and having heard arguments of counsel, it is

ORDERED that said motion be and the same hereby is granted, and it is further

ORDERED that this Court's Order of June 28, 1979, is amended, pursuant to 28 U. S. C. § 1292(b), to include the following statement:

> "This Order involves a controlling question of law as to which there is substantial ground for difference of opinion, and an immediate appeal from this Order may materially advance the ultimate termination of the litigation.
>
> The controlling question of law presented for review is whether a federal private right of action for damages exists under the Trust Indenture Act of 1939, 15 U. S. C. §§ 77aaa *et seq.*, in favor of debentureholders against an indenture trustee for alleged breach of a trust indenture contract conforming to the requirements of the Act."

and it is further

ORDERED that all proceedings in these cases are hereby stayed until the United States Court of Appeals for the Third Circuit acts on this interlocutory appeal.

/s/ LOUIS C. BECHTLE, *J.*
Louis C. Bechtle, *J.*

DATED: July 30, 1979

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

August 21, 1979

C. A. Miscellaneous Record No. 79-8199

JAY A. ZEFFIRO, et al.

v.

FIRST PENNSYLVANIA BANKING
AND TRUST COMPANY

(D. C. Civil No. 78-3294)

HARRY M. BERNARD, JR., et al.

v.

FIRST PENNSYLVANIA BANK N. A., and
CAPITAL FIRST CORPORATION

(D. C. Civil No. 78-4316)

FIRST PENNSYLVANIA BANK N. A.,
Petitioner

Present: SEITZ, *Chief Judge*, and ADAMS and GIBBONS, *Circuit Judges.*

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1. Petition for permission to appeal pursuant to 28 U. S. C. § 1292(b)
2. Answer by respondents to petition for permission to appeal

in the above-entitled case.

Respectfully,

/s/ T. F. QUINN
Clerk

nj
Enclosure

The foregoing petition is granted.

By THE COURT,

/s/ SEITZ
Chief Circuit Judge

Dated: August 27, 1979

[Entered August 28, 1979]

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2259

ZEFFIRO, Jay A., Individually and on Behalf of All Other Persons Similarly Situated

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY, a Pennsylvania Corporation

(D. C. Civil No. 78-3294)

SMITH, Isabella G., BERNARD, Harry M. Jr., on Behalf of Themselves and All Others Similarly Situated

v.

FIRST PENNSYLVANIA BANK, N. A.
CAPITAL FIRST CORPORATION

(D. C. Civil 78-4316)

FIRST PENNSYLVANIA BANK N. A.,
Appellant

(D. C. Civil Nos. 78-3294 and 78-4316)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: ROSENN and HIGGINBOTHAM, *Circuit Judges* and LAYTON, *District Judge**

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* Honorable Caleb R. Layton, 3rd, Senior United States District Judge for the District of Delaware, sitting by designation.

JUDGMENT.

[Entered May 29, 1980]

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on February 21, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed June 29, 1979, be, and the same is hereby affirmed. Costs taxed against appellant.

ATTEST:
/s/ THOMAS F. QUINN
Clerk

May 29, 1980

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2259

JAY A. ZEFFIRO, Individually and on Behalf of All Other Persons Similarly Situated

v.

FIRST PENNSYLVANIA BANKING AND TRUST COMPANY, a Pennsylvania Corporation

ISABELLA G. SMITH, HARRY M. BERNARD, JR., on Behalf of All Other Persons Similarly Situated and Themselves

v.

FIRST PENNSYLVANIA BANK N. A. and CAPITAL FIRST CORPORATION

FIRST PENNSYLVANIA BANK N. A.,
Appellant

SUR PETITION FOR REHEARING.

[Entered June 26, 1980]

Present: SEITZ, *Chief Judge*, ALDISERT, GIBBONS, ROSENN, HUNTER, WEIS, GARTH, HIGGINBOTHAM, *Circuit Judges*, and LAYTON, *District Judge**

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* Sitting by designation.

The petition for rehearing filed by appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By THE COURT,

/s/ MAX ROSENN
Judge

Dated: June 26, 1980

STATUTES INVOLVED.

Relevant Sections of the Trust Indenture Act of 1939, 15 U. S. C. §§ 77aaa *et seq.*

Section 302, 15 U. S. C. § 77bbb. Necessity for regulation.

(a) Upon the basis of facts disclosed by the reports of the Securities and Exchange Commission made to the Congress pursuant to section 78jj of this title and otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors in notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, which are offered to the public, are adversely affected—

(1) when the obligor fails to provide a trustee to protect and enforce the rights and to represent the interests of such investors, notwithstanding the fact that (A) individual action by such investors for the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action, and (B) concerted action by such investors in their common interest through representatives of their own selection is impeded by reason of the wide dispersion of such investors through many States, and by reason of the fact that information as to the names and addresses of such investors generally is not available to such investors;

(2) when the trustee does not have adequate rights and powers, or adequate duties and responsibilities, in connection with matters relating to the protection and enforcement of the rights of such investors; when, notwithstanding the obstacles to con-

certed action by such investors, and the general and reasonable assumption by such investors that the trustee is under an affirmative duty to take action for the protection and enforcement of their rights, trust indentures (A) generally provide that the trustee shall be under no duty to take any such action, even in the event of default, unless it receives notice of default, demand for action, and indemnity, from the holders of substantial percentages of the securities outstanding thereunder, and (B) generally relieve the trustee from liability even for its own negligent action or failure to act;

(3) when the trustee does not have resources commensurate with its responsibilities, or has any relationship to or connection with the obligor or any underwriter of any securities of the obligor, or holds, beneficially or otherwise, any interest in the obligor or any such underwriter, which relationship, connection, or interest involves a material conflict with the interests of such investors;

(4) when the obligor is not obligated to furnish to the trustee under the indenture and to such investors adequate current information as to its financial condition, and as to the performance of its obligations with respect to the securities outstanding under such indenture; or when the communication of such information to such investors is impeded by the fact that information as to the names and addresses of such investors generally is not available to the trustee and to such investors;

(5) when the indenture contains provisions which are misleading or deceptive, or when full and fair disclosure is not made to prospective investors of the effect of important indenture provisions; or

(6) when, by reason of the fact that trust indentures are commonly prepared by the obligor or underwriter in advance of the public offering of the securities to be issued thereunder, such investors are unable to participate in the preparation thereof, and, by reason of their lack of understanding of the situation, such investors would in any event be unable to procure the correction of the defects enumerated in this subsection.

(b) Practices of the character above enumerated have existed to such an extent that, unless regulated, the public offering of notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, by the use of means and instruments of transportation and communication in interstate commerce and of the mails, is injurious to the capital markets, to investors, and to the general public; and it is hereby declared to be the policy of this subchapter, in accordance with which policy all the provisions of this subchapter shall be interpreted, to meet the problems and eliminate the practices, enumerated in this section, connected with such public offerings.

Section 306, 15 U. S. C. § 77fff. Securities not registered under Securities Act.

(a) Prohibitions affecting unregistered securities not issued under indenture.

In the case of any security which is not registered under the Securities Act of 1933 [15 U. S. C. 77a et seq.] and to which this subsection is applicable notwithstanding the provisions of section 77ddd of this title, unless such security has been or is to be issued under an indenture and an application for qualification is effective as to such

indenture, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) Prohibitions affecting unregistered securities issued under indenture.

In the case of any security which is not registered under the Securities Act of 1933 [15 U. S. C. 77a et seq.], but which has been or is to be issued under an indenture as to which an application for qualification is effective, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any such security, unless such prospectus, to the extent the Commission may prescribe by rules and regulations as necessary and appropriate in the public interest or for the protection of investors, includes or is accompanied by a written statement that contains the information specified in subsection (c) of section 77eee of this title; or

(2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless, to the extent the Commission may prescribe by rules

and regulations as necessary or appropriate in the public interest or for the protection of investors, accompanied or preceded by a written statement that contains the information specified in subsection (c) of section 77eee of this title.

(c) Necessity of issuance under indenture; application for qualification.

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell through the use or medium of any prospectus or otherwise any security which is not registered under the Securities Act of 1933 [15 U. S. C. 77a et seq.] and to which this subsection is applicable notwithstanding the provisions of section 77ddd of this title, unless such security has been or is to be issued under an indenture and an application for qualification has been filed as to such indenture, or while the application is the subject of a refusal order or stop order or (prior to qualification) any public proceeding or examination under section 77ggg(c) of this title.

Section 310(b), 15 U. S. C. § 77jjj(b). Disqualification of trustee.

The indenture to be qualified shall provide that if any indenture trustee has or shall acquire any conflicting interest as hereinafter defined, (i) such trustee shall, within ninety days after ascertaining that it has such conflicting interest, either eliminate such conflicting interest or resign, such resignation to become effective upon the appointment of a successor trustee and such successor's acceptance of such appointment, and the obligor upon the indenture securities shall take prompt steps to have a successor ap-

pointed in the manner provided in the indenture; and (ii) in the event that such trustee shall fail to comply with the provisions of clause (i) of this subsection, such trustee shall, within ten days after the expiration of such ninety-day period, transmit notice of such failure to the indenture security holders in the manner and to the extent provided in subsection (c) of section 77mmm of this title; and (iii) subject to the provisions of subsection (e) of section 77*ooo* of this title, any security holder who has been a bona fide holder of indenture securities for at least six months may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction for the removal of such trustee, and the appointment of a successor, if such trustee fails, after written request therefor by such holder, to comply with the provisions of clause (i) of this subsection. For the purposes of this subsection, an indenture trustee shall be deemed to have a conflicting interest if—

(1) such trustee is trustee under another indenture under which any other securities, or certificates of interest or participation in any other securities, of an obligor upon the indenture securities are outstanding unless (A) the indenture securities are collateral trust notes under which the only collateral consists of securities issued under such other indenture, or (B) such other indenture is a collateral trust indenture under which the only collateral consists of indenture securities, or (C) such obligor has no substantial unmortgaged assets and is engaged primarily in the business of owning, or of owning and developing and/or operating, real estate, and the indenture to be qualified and such other indenture are secured by wholly separate and distinct parcels of real estate: *Provided,* That the indenture to be qualified may contain a provision excluding from the operation of

this paragraph another indenture or indentures under which other securities, or certificates of interest or participation in other securities, of such an obligor are outstanding, if (i) the indenture to be qualified and such other indenture or indentures are wholly unsecured, and such other indenture or indentures are specifically described in the indenture to be qualified or are thereafter qualified under this subchapter, unless the Commission shall have found and declared by order pursuant to subsection (b) of section 77eee or subsection (c) of section 77ggg of this title that differences exist between the provisions of the indenture to be qualified and the provisions of such other indenture or indentures which are so likely to involve a material conflict of interest as to make it necessary in the public interest or for the protection of investors to disqualify such trustee from acting as such under one of such indentures, or (ii) the issuer shall have sustained the burden of proving, on application to the Commission and after opportunity for hearing thereon, that trusteeship under the indenture to be qualified and such other indenture is not so likely to involve a material conflict of interest as to make it necessary in the public interest or for the protection of investors to disqualify such trustee from acting as such under one of such indentures;

(2) such trustee or any of its directors or executive officers is an obligor upon the indenture securities or an underwriter for such an obligor;

(3) such trustee directly or indirectly controls or is directly or indirectly controlled by or is under direct or indirect common control with an obligor upon the indenture securities or an underwriter for such an obligor;

(4) such trustee or any of its directors or executive officers is a director, officer, partner, employee, appointee, or representative of an obligor upon the indenture securities, or of an underwriter (other than the trustee itself) for such an obligor who is currently engaged in the business of underwriting, except that (A) one individual may be a director and/or an executive officer of the trustee and a director and/or an executive officer of such obligor, but may not be at the same time an executive officer of both the trustee and of such obligor, and (B) if and so long as the number of directors of the trustee in office is more than nine, one additional individual may be a director and/or an executive officer of the trustee and a director of such obligor, and (C) such trustee may be designated by any such obligor or by any underwriter for any such obligor, to act in the capacity of transfer agent, registrar, custodian, paying agent, fiscal agent, escrow agent, or depositary, or in any other similar capacity, or, subject to the provisions of paragraph (1) of this subsection, to act as trustee, whether under an indenture or otherwise;

(5) 10 per centum or more of the voting securities of such trustee is beneficially owned either by an obligor upon the indenture securities or by any director, partner, or executive officer thereof, or 20 per centum or more of such voting securities is beneficially owned, collectively, by any two or more of such persons; or 10 per centum or more of the voting securities of such trustee is beneficially owned either by an underwriter for any such obligor or by any director, partner, or executive officer thereof, or is beneficially owned, collectively, by any two or more such persons;

(6) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, (A) 5 per centum or more of the voting securities, or 10 per centum or more of any other class of security, of an obligor upon the indenture securities, not including indenture securities and securities issued under any other indenture under which such trustee is also trustee, or (B) 10 per centum or more of any class of security of an underwriter for any such obligor;

(7) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, 5 per centum or more of the voting securities of any person who, to the knowledge of the trustee, owns 10 per centum or more of the voting securities of, or controls directly or indirectly or is under direct or indirect common control with, an obligor upon the indenture securities;

(8) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, 10 per centum or more of any class of security of any person who, to the knowledge of the trustee, owns 50 per centum or more of the voting securities of an obligor upon the indenture securities; or

(9) such trustee owns, on May 15 in any calendar year, in the capacity of executor, administrator, testamentary or inter vivos trustee, guardian, committee or conservator, or in any other similar capacity, an aggregate of 25 per centum or more of the voting securities, or of any class of security, of any person, the beneficial ownership of a specified percentage of which would have constituted a conflicting interest

under paragraph (6), (7), or (8) of this subsection. The indenture to be qualified may provide, as to any such securities of which the indenture trustee acquired ownership through becoming executor, administrator, or testamentary trustee of an estate which included them, that the provisions of the preceding sentence shall not apply, for a period of not more than two years from the date of such acquisition, to the extent that such securities included in such estate do not exceed 25 per centum of such voting securities or 25 per centum of any such class of security. The indenture to be qualified shall provide that promptly after May 15 in each calendar year, the trustee shall make a check of its holdings of such securities in any of the above-mentioned capacities as of such May 15. Such indenture shall also provide that if the obligor upon the indenture securities fails to make payment in full of principal or interest under such indenture when and as the same becomes due and payable, and such failure continues for thirty days thereafter, the trustee shall make a prompt check of its holdings of such securities in any of the above-mentioned capacities as of the date of the expiration of such thirty-day period, and after such date, notwithstanding the foregoing provisions of this paragraph, all such securities so held by the trustee, with sole or joint control over such securities vested in it, shall be considered as though beneficially owned by such trustee, for the purposes of paragraphs (6), (7), and (8) of this subsection.

The indenture to be qualified shall provide that the specification of percentages in paragraphs (5) to (9), inclusive, of this subsection shall not be construed as indi-

cating that the ownership of such percentages of the securities of a person is or is not necessary or sufficient to constitute direct or indirect control for the purposes of paragraph (3) or (7) of this subsection.

For the purposes of paragraphs (6), (7), (8), and (9) of this subsection, (A) the terms "security" and "securities" shall include only such securities as are generally known as corporate securities, but shall not include any note or other evidence of indebtedness issued to evidence an obligation to repay moneys lent to a person by one or more banks, trust companies, or banking firms, or any certificate of interest or participation in any such note or evidence of indebtedness; (B) an obligation shall be deemed to be in default when a default in payment of principal shall have continued for thirty days or more, and shall not have been cured; and (C) the indenture trustee shall not be deemed the owner or holder of (i) any security which it holds as collateral security (as trustee or otherwise) for an obligation which is not in default as above defined, or (ii) any security which it holds as collateral security under the indenture to be qualified, irrespective of any default thereunder, or (iii) any security which it holds as agent for collection, or as custodian, escrow agent, or depositary, or in any similar representative capacity.

For the purposes of this subsection, the term "underwriter" when used with reference to an obligor upon the indenture securities means every person who, within three years prior to the time as of which the determination is made, was an underwriter of any security of such obligor outstanding at such time.

Section 311(a), (b), 15 U. S. C. § 77kkk(a), (b). Preferential collection of claims against obligor.

(a) Trustee as creditor of obligor.

Subject to the provisions of subsection (b) of this section, the indenture to be qualified shall provide that if the indenture trustee shall be, or shall become, a creditor, directly or indirectly, secured or unsecured, of an obligor upon the indenture securities, within four months prior to a default as defined in the last paragraph of this subsection, or subsequent to such a default, then, unless and until such default shall be cured, such trustee shall set apart and hold in a special account for the benefit of the trustee individually and the indenture security holders—

(1) an amount equal to any and all reductions in the amount due and owing upon any claim as such creditor in respect of principal or interest, effected after the beginning of such four months' period and valid as against such obligor and its other creditors, except any such reduction resulting from the receipt or disposition of any property described in paragraph (2) of this subsection, or from the exercise of any right of setoff which the trustee could have exercised if a petition in bankruptcy had been filed by or against such obligor upon the date of such default; and

(2) all property received in respect of any claim as such creditor, either as security therefor, or in satisfaction or composition thereof, or otherwise, after the beginning of such four months' period, or an amount equal to the proceeds of any such property, if disposed of, subject, however, to the rights, if any, of such obligor and its other creditors in such property or such proceeds.

Nothing herein contained shall affect the right of the indenture trustee—

(A) to retain for its own account (i) payments made on account of any such claim by any person (other than such obligor) who is liable thereon, and (ii) the proceeds of the bona fide sale of any such claim by the trustee to a third person, and (iii) distributions made in cash, securities, or other property in respect of claims filed against such obligor in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act [11 U. S. C. 1 et seq.] or applicable State law;

(B) to realize, for its own account, upon any property held by it as security for any such claim, if such property was so held prior to the beginning of such four months' period;

(C) to realize, for its own account, but only to the extent of the claim hereinafter mentioned, upon any property held by it as security for any such claim, if such claim was created after the beginning of such four months' period and such property was received as security therefor simultaneously with the creation thereof, and if the trustee shall sustain the burden of proving that at the time such property was so received the trustee had no reasonable cause to believe that a default as defined in the last paragraph of this subsection would occur within four months; or

(D) to receive payment on any claim referred to in paragraph (B) or (C) of this subsection, against the release of any property held as security for such claim as provided in said paragraph (B) or (C), as the case may be, to the extent of the fair value of such property.

For the purposes of paragraphs (B), (C), and (D) of this subsection, property substituted after the beginning of such four months' period for property held as security at the time of such substitution shall, to the extent of the fair value of the property released, have the same status as the property released, and, to the extent that any claim referred to in any of such paragraphs is created in renewal of or in substitution for or for the purpose of repaying or refunding any preexisting claim of the indenture trustee as such creditor, such claim shall have the same status as such preexisting claim.

The indenture to be qualified shall provide that, if the trustee shall be required to account, the funds and property held in such special account and the proceeds thereof shall be apportioned between the trustee and the indenture security holders in such manner that the trustee and the indenture security holders realize, as a result of payments from such special account and payments of dividends on claims filed against such obligor in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act [11 U. S. C. 1 et seq.] or applicable State law, the same percentage of their respective claims, figured before crediting to the claim of the trustee anything on account of the receipt by it from such obligor of the funds and property in such special account and before crediting to the respective claims of the trustee and the indenture security holders dividends on claims filed against such obligor in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act or applicable State law, but after crediting thereon receipts on account of the indebtedness represented by their respective claims from all sources other than from such dividends and from the funds and property so held in such special account. As used in this paragraph,

with respect to any claim, the term "dividends" shall include any distribution with respect to such claim, in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act or applicable State law, whether such distribution is made in cash, securities, or other property, but shall not include any such distribution with respect to the secured portion, if any, of such claim. The court in which such bankruptcy, receivership, or proceeding for reorganization is pending shall have jurisdiction (i) to apportion between the indenture trustee and the indenture security holders, in accordance with the provisions of this paragraph, the funds and property held in such special account and the proceeds thereof, or (ii) in lieu of such apportionment, in whole or in part, to give to the provisions of this paragraph due consideration in determining the fairness of the distributions to be made to the indenture trustee and the indenture security holders with respect to their respective claims, in which event it shall not be necessary to liquidate or to appraise the value of any securities or other property held in such special account or as security for any such claim, or to make a specific allocation of such distributions as between the secured and unsecured portions of such claims, or otherwise to apply the provisions of this paragraph as a mathematical formula.

Any indenture trustee who has resigned or been removed after the beginning of such four months' period shall be subject to the provisions of this subsection as though such resignation or removal had not occurred. Any indenture trustee who has resigned or been removed prior to the beginning of such four months' period shall be subject to the provisions of this subsection if and only if the following conditions exist—

(i) the receipt of property or reduction of claim which would have given rise to the obligation to account, if such indenture trustee had continued as trustee, occurred after the beginning of such four months' period; and

(ii) such receipt of property or reduction of claim occurred within four months after such resignation or removal.

As used in this subsection, the term "default" means any failure to make payment in full of principal or interest, when and as the same becomes due and payable, under any indenture which has been qualified under this subchapter, and under which the indenture trustee is trustee and the person of whom the indenture trustee is directly or indirectly a creditor is an obligor; and the term "indenture security holder" means all holders of securities outstanding under any such indenture under which any such default exists.

(b) Exclusion of creditor relationship arising from specified classes.

The indenture to be qualified may contain provisions excluding from the operation of subsection (a) of this section a creditor relationship arising from—

(1) the ownership or acquisition of securities issued under any indenture, or any security or securities having a maturity of one year or more at the time of acquisition by the indenture trustee;

(2) advances authorized by a receivership or bankruptcy court of competent jurisdiction, or by the indenture, for the purpose of preserving the property subject to the lien of the indenture or of discharging

tax liens or other prior liens or encumbrances on the trust estate, if notice of such advance and of the circumstances surrounding the making thereof is given to the indenture security holders, at the time and in the manner provided in the indenture;

(3) disbursements made in the ordinary course of business in the capacity of trustee under an indenture, transfer agent, registrar, custodian, paying agent, fiscal agent or depositary, or other similar capacity;

(4) an indebtedness created as a result of services rendered or premises rented; or an indebtedness created as a result of goods or securities sold in a cash transaction as defined in the indenture;

(5) the ownership of stock or of other securities of a corporation organized under the provisions of section 25(a) of the Federal Reserve Act, as amended [12 U. S. C. 611 et seq.], which is directly or indirectly a creditor of an obligor upon the indenture securities; or

(6) the acquisition, ownership, acceptance or negotiation of any drafts, bills of exchange, acceptances, or obligations which fall within the classification of self-liquidating paper as defined in the indenture.

Section 313, 15 U. S. C. § 77mmm. Reports by indenture trustee.

(a) Report to security holders; time; contents.

The indenture to be qualified shall contain provisions requiring the indenture trustee to transmit to the indenture security holders as hereinafter provided, at stated intervals of not more than 12 months, a brief report with respect to—

(1) its eligibility and its qualifications under section 77jjj of this title, or in lieu thereof, if to the best of its knowledge it has continued to be eligible and qualified under such section, a written statement to such effect;

(2) the character and amount of any advances made by it, as indenture trustee, which remain unpaid on the date of such report, and for the reimbursement of which it claims or may claim a lien or charge, prior to that of the indenture securities, on the trust estate or on property or funds held or collected by it as such trustee, if such advances so remaining unpaid aggregate more than one-half of 1 per centum of the principal amount of the indenture securities outstanding on such date;

(3) the amount, interest rate, and maturity date of all other indebtedness owning to it in its individual capacity, on the date of such report, by the obligor upon the indenture securities, with a brief description of any property held as collateral security therefor, except an indebtedness based upon a creditor relationship arising in any manner described in paragraphs (2), (3), (4), or (6) of subsection (b) of section 77kkk of this title;

(4) the property and funds physically in its possession as indenture trustee on the date of such report;

(5) any release, or release and substitution, of property subject to the lien of the indenture (and the consideration therefor, if any) which it has not previously reported;

(6) any additional issue of indenture securities which it has not previously reported; and

(7) any action taken by it in the performance of its duties under the indenture which it has not previously reported and which in its opinion materially affects the indenture securities or the trust estate, except action in respect of a default, notice of which has been or is to be withheld by it in accordance with an indenture provision authorized by subsection (b) of section 77*ooo* of this title.

(b) Additional reports to security holders.

The indenture to be qualified shall also contain provisions requiring the indenture trustee to transmit to the indenture security holders as hereinafter provided, within the times hereinafter specified, a brief report with respect to—

(1) the release, or release and substitution, of property subject to the lien of the indenture (and the consideration therefor, if any) unless the fair value of such property, as set forth in the certificate or opinion required by paragraph (1) of subsection (d) of section 77nnn of this title, is less than 10 per centum of the principal amount of indenture securities outstanding at the time of such release, or such release and substitution, such report to be so transmitted within 90 days after such time; and

(2) the character and amount of any advances made by it as such since the date of the last report transmitted pursuant to the provisions of subsection (a) of this section (or if no such report has yet been so transmitted, since the date of execution of the indenture), for the reimbursement of which it claims or may claim a lien or charge, prior to that of the indenture securities, on the trust estate or on property or funds held or collected by it as such trustee, and

which it has not previously reported pursuant to this paragraph, if such advances remaining unpaid at any time aggregate more than 10 per centum of the principal amount of indenture securities outstanding at such time, such report to be so transmitted within 90 days after such time.

(c) Additional parties to whom reports to be transmitted.

The indenture to be qualified shall also provide that reports pursuant to this section shall be transmitted by mail—

(1) to all registered holders of indenture securities, as the names and addresses of such holders appear upon the registration books of the obligor upon the indenture securities;

(2) to such holders of indenture securities as have, within the two years preceding such transmission, filed their names and addresses with the indenture trustee for that purpose; and

(3) except in the case of reports pursuant to subsection (b) of this section, to all holders of indenture securities whose names and addresses have been furnished to or received by the indenture trustee purant to section *77lll* of this title.

(d) Filing of report with stock exchanges.

The indenture to be qualified shall also provide that a copy of each such report shall, at the time of such transmission to indenture security holders, be filed with each stock exchange upon which the indenture securities are listed, and also with the Commission.

Section 315(b), 15 U. S. C. § 77ooo(b). Notice of defaults.

The indenture to be qualified shall contain provisions requiring the indenture trustee to give to the indenture

security holders, in the manner and to the extent provided in subsection (c) of section 77mmm of this title, notice of all defaults known to the trustee, within ninety days after the occurrence thereof: *Provided,* That such indenture may provide that, except in the case of default in the payment of the principal of or interest on any indenture security, or in the payment of any sinking or purchase fund installment, the trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee, or a trust committee of directors and/or responsible officers, of the trustee in good faith determine that the withholding of such notice is in the interests of the indenture security holders.

Section 315(c), 15 U. S. C. § 77ooo(c). Duties of the trustee in case of default.

The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

Section 322, 15 U. S. C. § 77vvv. Court review of orders; jurisdiction of offenses and suits.

(a) Orders of the Commission under this subchapter (including orders pursuant to the provisions of sections 77eee(b) and 77ggg(c) of this title) shall be subject to review in the same manner, upon the same conditions, and to the same extent, as provided in section 9 of the Securities Act of 1933 [15 U. S. C. 77i], with respect to orders of the Commission under such Act.

(b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to en-

force any liability created by, this subchapter, or any rules or regulations or orders prescribed under the authority thereof, shall be as provided in section 22(a) of the Securities Act of 1933 [15 U. S. C. 77v(a)].

Section 323, 15 U. S. C. § 77www. Liability for misleading statements.

(a) Any person who shall make or cause to be made any statement in any application, report, or document filed with the Commission pursuant to any provisions of this subchapter, or any rule, regulation, or order thereunder, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or who shall omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall be liable to any person (not knowing that such statement was false or misleading or of such omission) who, in reliance upon such statement or omission, shall have purchased or sold a security issued under the indenture to which such application, report, or document relates, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading or of such omission. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit and assess reasonable costs, including reasonable attorneys' fees, against either party litigant, having due regard to the merits and good faith of the suit or defense. No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the

cause of action and within three years after such cause of action accrued.

(b) The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist under the Securities Act of 1933 [15 U. S. C. 77a et seq.], or the Securities Exchange Act of 1934 [15 U. S. C. 78a et seq.], or the Public Utility Holding Company Act of 1935 [15 U. S. C. 79 et seq.], or otherwise at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this subchapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

Section 324, 15 U. S. C. § 77xxx. Unlawful representations.

It shall be unlawful for any person in offering, selling or issuing any security to represent or imply in any manner whatsoever that any action or failure to act by the Commission in the administration of this subchapter means that the Commission has in any way passed upon the merits of, or given approval to, any trustee, indenture or security, or any transaction or transactions therein, or that any such action or failure to act with regard to any statement or report filed with or examined by the Commission pursuant to this subchapter or any rule, regulation, or order thereunder, has the effect of a finding by the Commission that such statement or report is true and accurate on its face or that it is not false or misleading.

Section 325, 15 U. S. C. § 77yyy. Penalties.

Any person who willfully violates any provision of this subchapter or any rule, regulation, or order thereunder, or any person who willfully, in any application,

report, or document filed or required to be filed under the provisions of this subchapter or any rule, regulation, or order thereunder, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

Supreme Court, U. S.
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No. 80-108

IN THE

Supreme Court of the United States

October Term, 1980

FIRST PENNSYLVANIA BANK, N.A.,
Petitioner,

vs.

JAY A. ZEFFIRO and HARRY M. BERNARD, JR.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI

DANIEL M. BERGER
BERGER, KAPETAN, MALAKOFF
& MEYERS, P.C.
508 Law & Finance Building
Pittsburgh, Pennsylvania 15219
(412) 281-4200

ABRAHAM C. REICH
FOX, ROTHSCHILD, O'BRIEN
& FRANKEL
2000 Market Street
Philadelphia, Pennsylvania 19103
(215) 299-2090

ROBERT J. HENNESSEY
LARKIN, HOFFMAN, DALY
& LINDGREN, LTD.
1500 Northwestern Financial Center
7900 Xerxes Avenue, South
Minneapolis, Minnesota 55431
(612) 835-3800

Attorneys for Respondents,
Jay A. Zeffiro and
Harry M. Bernard, Jr.

Of Counsel:

MICHAEL P. MALAKOFF
RICHARD A. FINBERG
508 Law & Finance Building
Pittsburgh, Pennsylvania 15219

JOSEPH W. ANTHONY
LARKIN, HOFFMAN, DALY
& LINDGREN, LTD.
1500 Northwestern Financial Center
7900 Xerxes Avenue, South
Minneapolis, Minnesota 55431

BATAVIA TIMES, APPELLATE COURT PRINTERS
EDWARD W. SHANNON, SENIOR REPRESENTATIVE
HAROLD L. BERKOBEN, REPRESENTATIVE
4700 CLAIRTON BLVD., PITTSBURGH, PA. 15236
PHONE: (412) 881-7400

QUESTION PRESENTED

A trust indenture is a private contract between an issuer of debt securities and an indenture trustee which defines the rights and duties that will govern the issuer, the trustee, and the security holders while the securities are outstanding.

Under the Trust Indenture Act of 1939 ("the Act"), 15 U. S. C. §§ 77aaa *et seq.*, nonexempted debt securities may not be offered or sold to the public unless the indenture relating to the securities has been "qualified" by the Securities and Exchange Commission ("SEC"). The indenture is qualified when the SEC certifies, *inter alia*, that it contains certain contractual provisions required by the Act.

The Act does not prohibit or declare unlawful the subsequent breach of required indenture provisions, nor does it expressly grant any private remedy for such a breach. The Act simply provides that the SEC may not qualify an indenture which does not contain the mandated provisions.

Other sections of the Act, by contrast, impose criminal penalties for specific statutory violations, and create an express federal private right of action for damages in favor of security holders who rely upon false or misleading statements made in documents filed with the SEC under the Act.

In the present case, holders of debt securities have sued an indenture trustee, petitioner First Pennsylvania Bank N. A. ("First Pennsylvania"), for alleged breaches of indenture provisions required by the Act. Although the complaints allege federal jurisdiction under the Act, no claim is made that First Pennsylvania violated the only section of the Act that expressly grants security holders a federal private right of action for damages.

Therefore, this case presents the important question explicitly left open by this Court in *Caplin v. Marine Midland Grace Trust Co.*, 406 U. S. 416 (1972):

> Whether a federal private right of action for damages or injunctive relief exists under the Trust Indenture Act of 1939, 15 U. S. C. §§ 77aaa *et seq.*, in favor of security holders against an indenture trustee for breach of provisions of a private trust indenture contract where those provisions are required by the Act to be included in the indenture contract.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	1
STATUTES INVOLVED	1
STATEMENT OF THE CASE	1
A. Allegations of the Complaints	1
B. Procedural History	3
C. The Court of Appeals Opinion	4
REASONS FOR GRANTING THE WRIT	7
A. The Decision Below Raises Questions of Exceptional Importance Which Should Be Settled by This Court	7
1. The Structure and Intent of the Trust Indenture Act of 1939	7
2. The Ruling of the Court of Appeals Threatens to Create a Nebulous and Unlimited "Federal Trust Law" Which Will Govern an Increasingly Large Number of Indenture Defaults	12
B. The Court of Appeals Decision Conflicts With This Court's Decisions in *Transamerica Mortgage Advisors, Inc. v. Lewis* and *Touche Ross & Co. v. Redington*	15
CONCLUSION	22
APPENDIX:	
Opinion of the United States Court of Appeals for the Third Circuit Entered May 29, 1980	A1

TABLE OF CONTENTS (Continued)

Page

Memorandum and Order of the United States District Court for the Eastern District of Pennsylvania Entered June 29, 1979 ..... A29

Order of the United States District Court for the Eastern District of Pennsylvania Entered July 31, 1979 .... A52

Order of the United States Court of Appeals for the Third Circuit Entered August 28, 1979 ..... A54

Judgment of the United States Court of Appeals for the Third Circuit Entered May 29, 1980 ..... A56

Order of the United States Court of Appeals for the Third Circuit Denying Petition for Rehearing Entered June 26, 1980 ..... A58

Statutes Involved A60

TABLE OF AUTHORITIES

Cases: Page

Caplin v. Marine Midland Grace Trust Co., 406 U. S. 416 (1972) ..... ii, 7, 10, 14, 15

Chrysler Corp. v. Brown, 441 U. S. 281 (1979) 16

Cort v. Ash, 422 U. S. 66 (1975) 16

Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976) 16

Fidelity Mortgage Investors v. First National City Bank, 387 F. Supp. 544 (S. D. N. Y. 1974) 13

Galdo v. First Pennsylvania Bank N. A., 250 Pa. Super. Ct. 385, 378 A. 2d 990 (1977, ... 13

Haas v. Palace Hotel Co., 101 Cal. App. 2d 108, 224 P. 2d 783 (1950), cert. denied, 342 U. S. 813 (1951) 13

In re Equity Funding Corp. of America Securities Litigation, 416 F. Supp. 161 (C. D. Cal. 1976), aff'd on other grounds, 603 F. 2d 1353 (9th Cir. 1979) 14

J. I. Case Co. v. Borak, 377 U. S. 426 (1964) 21

Kissinger v. Reporters Committee For Freedom of the Press, 48 U. S. L. W. 4223 (U. S. March 3, 1980) 15, 18

Mathews v. Fisher, [Current Binder] Fed. Sec. L. Rep. ¶ 97,336 (S. D. Ohio 1978) 14

Morris v. Cantor, 390 F. Supp. 817 (S. D. N. Y. 1975) 7, 14

National Railroad Passenger Corp. v. National Association of Railroad Passengers, 414 U. S. 453 (1974) 19

Piper v. Chris-Craft Indus., Inc., 430 U. S. 1 (1977) 16

Ray v. Marine Midland Grace Trust Co., 35 N. Y. 2d 147, 359 N. Y. S. 2d 28 (1974) 13

Rondeau v. Mosinee Paper Corp., 422 U. S. 49 (1975) 16

Santa Fe Indus., Inc. v. Green, 430 U. S. 462 (1977) 11, 16

Securities Investor Protection Corp. v. Barbour, 421 U. S. 412 (1975) 16

Touche Ross & Co. v. Redington, 442 U. S. 560 (1979) 5, 6, 15, 16, 17, 18, 19, 20, 21

TABLE OF AUTHORITIES (Continued)

Cases (Continued): Page

Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U. S. 11 (1979) 5, 6, 9, 15, 16, 17, 20, 21

United States Trust Co. v. First National City Bank, 57 A. D. 2d 285, 394 N. Y. S. 2d 653 (App. Div. 1977) 13

Young v. Distinctive Devices, Inc., No. 1119 (N. Y. Ct. App., Dec. 13, 1979), cert. denied, 48 U. S. L. W. 3733 (1980) 13

Zeffiro v. First Pennsylvania Banking and Trust Co., 473 F. Supp. 201 (E. D. Pa. 1979) 1

Zeffiro v. First Pennsylvania Banking and Trust Co., 82 F. R. D. 31 (E. D. Pa. 1979) 2

Statutes:

Investment Advisers Act of 1940, 15 U. S. C. §§ 80b-1 et seq. 16, 20, 21

Securities Exchange Act of 1934, 15 U. S. C. §§ 78a et seq. ..16, 19

Trust Indenture Act of 1939, 15 U. S. C. §§ 77aaa et seq. i, ii, 1, 2, 3, 7, 8, 9, 10, 11, 12, 15, 19, 20, 21

28 U. S. C. § 1254(1) 1

28 U. S. C. § 1292(b) 4

Court Rules:

Federal Rules of Civil Procedure, Rule 12 3

Other Authorities:

American Law Institute, Federal Securities Code (1980) ...11, 12

American Law Institute, Study of the Division of Jurisdiction Between State and Federal Courts (1968) 15

84 Congressional Record (1939) 20

Dropkin, Implied Civil Liability Under the Trust Indenture Act: Trends and Prospects, 52 Tulane L. Rev. 299 (1978) 11, 18

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TABLE OF AUTHORITIES (Continued)

Other Authorities (Continued): Page

Greene, Hybrid State Law in the Federal Courts, 83 Harv. L. Rev. 289 (1969) 12, 18
Hearings on H. R. 10292 before Subcomm. of Comm. on Interstate and Foreign Commerce, 75th Cong., 3d Sess. (1938) 10
House Report No. 1016, 76th Cong., 1st Sess. (1939) 11, 20
Johnson, Default Administration of Corporate Trust Indentures: The General Nature of the Trustee's Responsibility and Events of Default, 15 St. Louis U. L. J. 203 (1970) 13
Memorandum from Davis Polk & Wardwell to Professor Louis Loss (Jan. 10, 1977) 14
The New York Times, Jan. 6, 1980, § 12 (National Economic Survey) 13
Pennsylvania Law Journal (June 23, 1980) 14
Senate Report No. 248, 76th Cong., 1st Sess. (1939) 8, 20
557 Sec. Reg. & L. Rep. (BNA) (1980) 14
43 SEC Annual Report (1977) 13
Stark, The Trust Indenture Act of 1939 in the Proposed Federal Securities Code, 32 Vand. L. Rev. 527 (1979) 18
48 United States Law Week 2823 (1980) 14
48 United States Law Week 2077 (1979) 14
The Wall Street Journal, June 2, 1980 14
Welcoming Remarks of Chief Justice Burger, American Law Institute 1980 Annual Meeting 15

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit affirming the denial of First Pennsylvania's motions to dismiss the complaints is not yet officially reported, and is printed in the Appendix at pp. A1-A28.

The opinion of the United States District Court for the Eastern District of Pennsylvania denying First Pennsylvania's motions to dismiss the complaints is officially reported at 473 F. Supp. 201 (E. D. Pa. 1979), and is printed in the Appendix at pp. A29-A51.

JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit, dated May 29, 1980, was entered on May 29, 1980. (App. A56-A57). First Pennsylvania's timely petition for rehearing in banc, filed June 11, 1980, was denied by the United States Court of Appeals for the Third Circuit by Order entered June 26, 1980. (App. A58-A59).

The jurisdiction of this Court is invoked under and pursuant to 28 U. S. C. § 1254(1).

STATUTES INVOLVED

The Trust Indenture Act of 1939, 15 U. S. C. §§ 77aaa *et seq.* The relevant sections of the Act are set forth in the Appendix at pp. A60-A83.

STATEMENT OF THE CASE

A. Allegations of the Complaints

In May 1972, Capital Equipment Leasing Corporation, later known as Capital First Corporation ("Capital

First"),[1] issued certain 9% subordinated debentures due 1982 in the principal amount of $1,500,000. The debentures were issued pursuant to a trust indenture contract ("the Indenture") which named The First Pennsylvania Banking and Trust Company, a predecessor of petitioner First Pennsylvania, as indenture trustee. The Indenture was qualified under the Trust Indenture Act and contained, *inter alia,* those provisions which the Act requires to be included in a qualified indenture contract.

Subsequently, two class action complaints were filed by respondents Jay A. Zeffiro and Harry M. Bernard, Jr.[2] against First Pennsylvania seeking damages and equitable relief on behalf of past and present owners of the Capital First debentures, who claimed that their investments had become worthless. Although the complaints, which were consolidated by the District Court, alleged federal jurisdiction under section 322(b) of the Act, 15 U. S. C. § 77vvv(b) (App. A80-A81), no claim was made that First Pennsylvania had violated the only section of the Act that expressly grants security holders a federal private right of action for damages.[3] Instead, the complaints alleged that First Pennsylvania had breached certain provisions of the private trust indenture contract between First Pennsylvania and Capital First, resulting in the loss

1. Capital First was named as a defendant in the *Bernard* action but was never served with the complaint. On December 19, 1978, Capital First filed a petition for reorganization under Chapter 11 of the Bankruptcy Act, and all proceedings against it were automatically stayed. (App. A4, A31).

2. Isabella G. Smith, also named as a plaintiff in the *Bernard* action, withdrew from the litigation with the permission of the District Court. (App. A31). See *Zeffiro v. First Pennsylvania Banking and Trust Co.*, 82 F. R. D. 31 (E. D. Pa. 1979).

3. Section 323 of the Act, 15 U. S. C. § 77www (App. A81-A82), discussed at pp. 9, 19 *infra.*

of plaintiffs' investments, and that First Pennsylvania should be found liable to plaintiffs on a theory of implied liability under the Act for negligence, breach of contract and breach of trust.

Specifically, the complaints charged violations of the following provisions of the Indenture, all of which were mandated by the Act to be included in an indenture qualified by the SEC: (1) Section 6-1(b) of the Indenture, required by section 315(c) of the Act (App. A80), which allegedly required First Pennsylvania to exercise the care and skill of a "prudent man" after Capital First's alleged defaults; (2) Section 7-3 of the Indenture, required by section 313 of the Act (App. A76-A79), which allegedly required First Pennsylvania to transmit certain reports to plaintiffs; (3) Section 6-2 of the Indenture, required by section 315(b) of the Act (App. A79-A80), which allegedly required First Pennsylvania to transmit notices of Capital First's alleged defaults to plaintiffs; (4) Section 6-8 of the Indenture, required by section 310(b) of the Act (App. A64-A70), which allegedly required First Pennsylvania to take certain action in the event that a conflict of interest arose between it and plaintiffs; and (5) Section 6-13 of the Indenture, required by section 311(a) of the Act (App. A71-A76), which allegedly required First Pennsylvania to segregate certain assets which it received as a creditor of Capital First. (App. A4).[4]

B. Procedural History

First Pennsylvania moved to dismiss the complaints, pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6), for

4. The complaints also alleged that First Pennsylvania had breached certain provisions of the Indenture which the Act permitted, but did not require, to be included in a qualified indenture. The court below held that breach of these permissive provisions did not give rise to a federal private right of action under the Act.

lack of subject matter jurisdiction and for failure to state a federal claim under the Act. On June 28, 1979, the United States District Court for the Eastern District of Pennsylvania denied the motions to dismiss (App. A29-A51), but certified its decision for interlocutory appeal under 28 U. S. C. § 1292(b) as involving a controlling question of law as to which there was substantial ground for difference of opinion. The question certified was "whether a federal private right of action for damages exists under the Trust Indenture Act . . . in favor of debentureholders against an indenture trustee for alleged breach of a trust indenture contract conforming to the requirements of the Act." (App. A52-A53).

The United States Court of Appeals for the Third Circuit thereafter granted First Pennsylvania permission to appeal from the certified order of the District Court. (App. A54-A55). On May 29, 1980, after briefing and oral argument in which the Securities and Exchange Commission participated as *amicus curiae*, a divided panel of the Court of Appeals affirmed, holding that plaintiffs had an implied federal private right of action under the Act to maintain their damage suits against First Pennsylvania for breach of indenture provisions mandated by the Act. (App. A1-A28, A56-A57). First Pennsylvania's timely petition for rehearing in banc was denied by the Court of Appeals on June 26, 1980. (App. A58-A59).

C. The Court of Appeals Opinion

The holding of the panel majority was predicated on the assumption that Congress, in the Act, had sought to impose a nationally uniform solution to questions arising under mandatory provisions of trust indenture contracts, and that implication of a federal private right of action would be a "necessary and helpful" means of effectuating

that supposed congressional purpose. According to the opinion of the panel majority:

> "A necessary means of facilitating the national uniformity goal of the Act would be through enforcement of the indenture in a federal forum. It is hard to believe that Congress would have established uniform standards to govern indentures and then paradoxically have allowed the application of those standards to depend on the law of the state of the suit. The interpretation of the indenture provisions mandated by the Act does not depend on ordinary contract principles—the intent of the parties—but depends on an interpretation of the legislation. It would be contrary to the purposes of the Act to have the trustee held to certain standards in one state court and potentially different standards in another. Thus, federal court jurisdiction is necessary to achieve the uniform standards intended by the Act." (App. A20-A21, footnotes omitted).

The panel majority further found the decisions of this Court in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U. S. 11 (1979), and *Touche Ross & Co. v. Redington*, 442 U. S. 560 (1979), to be "easily distinguishable" from the present case, and summarily disposed of them in a single footnote. (App. A24-A25).

In a separate, dissenting opinion, Judge Layton rejected the analysis of the panel majority and concluded that a federal private right of action could not be implied under the Act. (App. A25-A28). Both *Lewis* and *Touche Ross*, reasoned Judge Layton, control the disposition of the case at bar, and those decisions require a showing that Congress *intended* to create a private right of action when it did not do so expressly. Significantly, Judge Layton found

no evidence whatsoever that Congress, in the Act, intended either to impose a nationally uniform solution to trust indenture questions or to create a federal private right of action for breach of mandated indenture provisions. Instead, he found in the language and legislative history of the Act a clear indication that Congress intended state, not federal, courts to adjudicate suits for breach of qualified indenture contracts. Thus, concluded Judge Layton, the result imposed by the panel majority contravened the expressed intent of Congress in the Act, and conflicted with the standards of statutory construction articulated by this Court in *Lewis* and *Touche Ross*.

REASONS FOR GRANTING THE WRIT

A. The Decision Below Raises Questions of Exceptional Importance Which Should Be Settled by This Court

The ruling of the Court of Appeals that a federal private right of action for damages may be implied under the Trust Indenture Act raises questions of exceptional importance expressly left open by this Court in *Caplin v. Marine Midland Grace Trust Co.*, 406 U S. 416, 426-27 n. 17, 433 n. 23 (1972). By holding that the Act was designed to impose uniform national standards which can best be enforced in federal courts, the Court of Appeals has invited wholesale transfer of breach of contract litigation involving trust indentures from the state courts to the federal courts.

Prior to the passage of the Act, questions relating to trust indentures "had been governed by the common law of contracts and fiduciary obligations, articulated primarily in the state courts." *Morris v. Cantor*, 390 F. Supp. 817, 819 (S. D. N. Y. 1975). The Court of Appeals majority conceded that the "legislative history of the Act does not explicitly deal with the ability of investors to bring suit in federal court," (App. A16), and "does not specify the proper forum" for a suit against an indenture trustee for breach of indenture provisions mandated by the Act (App. A17). In concluding nevertheless that federal courts should be able to entertain such suits, even in the absence of express congressional authorization, the Court of Appeals majority ignored the intent of Congress as reflected in the language and legislative history of the Act.

1. The Structure and Intent of the Trust Indenture Act of 1939

The Trust Indenture Act was the last major New Deal legislation dealing with the securities markets. It was

designed to respond, through a system of limited federal regulation, to certain specific deficiencies that were prevalent in trust indenture contracts of the time. Thus, Section 302 of the Act, 15 U. S. C. § 77bbb (App. A60-A62), entitled "Necessity for regulation," identifies six "practices" unearthed in the congressional hearings which the Act was designed to "eliminate." Principal among such practices was the inclusion of standard provisions in indentures relieving negligent trustees from any liability for wrongdoing and relieving the trustee from any duty to take action in the event of a default.[5] As the Senate Report[6] indicated:

> "The bill proceeds on the theory that *the proper remedy is to correct these deficiencies in the trust indenture,* and that the appropriate time to correct those deficiencies is before the bonds are offered in interstate commerce or through the mails."

To "correct those deficiencies" identified in the hearings, Congress chose to require certain provisions to be included in every indenture qualified by the SEC, and to prohibit other, exculpatory provisions. Sections 310 through 318 of the Act, portions of which provide the basis for the claims made in this case (App. A64-A80), identify the terms which are required, prohibited, or permitted in a qualified trust indenture. Those sections characteristically begin by stating that "The indenture to be qualified shall [or may or shall not] contain provisions requiring" certain actions by the indenture trustee or others.

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5. Section 302(a)(2), 15 U. S. C. § 77bbb(a)(2) (App. A60-A61).

6. S. Rep. No. 248, 76th Cong., 1st Sess. 8 (1939) ("Senate Report"). (Emphasis added).

While sections 310 through 318 of the Act mandate the inclusion of certain provisions in qualified trust indentures before the underlying securities may be sold to the public, those sections do not prohibit any subsequent breaches of the required indenture provisions, nor do they expressly create any federal private right of action to sue an indenture trustee for breaches of such provisions. This failure to declare such breaches unlawful or to provide a federal right to sue for damages resulting from such breaches stands in marked contrast to section 323 of the Act. (App. A81-A82). That section, as this Court noted in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U. S. at 20-21 & n. 10, expressly provides a federal right to sue in favor of any person who purchases or sells a security issued under an indenture in reliance upon false or misleading statements contained in documents filed with the SEC under the Act.

The failure to provide a federal private right of action to sue for breach of provisions required to be included in a qualified indenture by sections 310 through 318 of the Act was no drafting error. Instead, it reflects a conscious congressional choice to leave the injured debt security holder to his adequate and traditional state law remedies, now fortified by federal prohibition of exculpatory provisions relieving trustees of liability. Rather than open federal courts to a flood of state contract suits, Congress intended to leave the state courts jurisdiction over such disputes. As Judge Layton, dissenting, noted in the Court of Appeals (App. A25-A28), this is clear not only from the statutory language and history, but also from the testimony given during the hearings on the Act by then-SEC Chairman William O. Douglas, who explicitly stated that:

> "The indenture, after it has been 'qualified' under this statute, will be enforceable in the same manner

> as any other contract is enforceable, *in the same manner that indentures presently executed are enforceable.*"[7]

The conscious decision of Congress to leave such contract suits in the state courts is well-illustrated also by the claims made both in this case and in *Caplin, supra,* that the indenture trustee failed to take actions mandated by section 315(c) of the Act after the obligor's default (App. A4). That section, entitled "Duties of the trustee in case of default," provides that:

> "The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of *default* (*as such term is defined in such indenture*) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a *prudent man* would exercise or use under the circumstances in the conduct of his own affairs." (App. A80). (Emphasis added).

Conspicuously, the Act does not define the key term "default," but instead leaves the definition of that critical term to the contracting parties. Any determination of whether such a "default" has occurred would necessarily be determined by resort to the intent of the contracting parties and the applicable state law. Moreover, if a state court decided that a "default" had occurred, it then would be obliged to measure the post-default actions of the trustee against the "prudent man" standard. Once again, this crucial term is not defined by the Act, and the legislative history clearly indicates that Congress meant only to adopt the traditional state law standard "applicable in

7. Hearings on H. R. 10292 Before Subcomm. of Comm. on Interstate and Foreign Commerce, 75th Cong., 3d Sess. 22 (1938). (Emphasis added).

the field of personal trusts." [8] Indeed, a recent law review article which analyzed the very question presented for review in this case concluded:

> "*When Congress enacted [the Trust Indenture Act], it intended neither to allow bondholders resort to a federal forum nor to federalize the prudent man concept.* It simply sought to mandate that a particular private contract, namely the indenture, should now contain a provision establishing the appropriate standard of trustee conduct during default administration." Dropkin, *Implied Civil Liability Under the Trust Indenture Act: Trends and Prospects*, 52 Tul. L. Rev. 299, 323 (1978). (Emphasis added).

The American Law Institute has similarly concluded that "the 'prudent man' test in [§] 315(c) . . . might well receive different constructions under the laws of the several states." ALI Federal Securities Code xxxviii (1980).

In sum, the reliance in required indenture provisions upon state law—which the Court of Appeals majority found "hard to believe" (App. A20)—is not only permitted, but is clearly required, by the Act. Conceptual confusion is likely to arise not from the application of settled state law to give meaning to the Act's "uniform standards," but rather from the application of a nebulous and undefined federal common law of trusts, the substance of which is nowhere found in the statute or the legislative history of the Act, and the evolution of which would hopelessly and impermissibly enmesh the federal courts in areas traditionally and deliberately relegated to state law. It was just such a confusion that this Court refused to permit in *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 478-79 (1977), where it declared that:

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8. H. R. Rep. No. 1016, 76th Cong., 1st Sess. 55 (1939) ("House Report").

"The result would be to bring within the Rule [10b-5] a wide variety of corporate conduct traditionally left to state regulation. In addition to posing a 'danger of vexatious litigation . . . ,' this extension of the federal securities laws would overlap and quite possibly interfere with state corporate law. Federal courts applying a 'federal fiduciary principle' under Rule 10b-5 could be expected to depart from state fiduciary standards at least to the extent necessary to ensure uniformity within the federal system. *Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.*" (Emphasis added and footnote omitted).[9]

2. The Ruling of the Court of Appeals Threatens to Create a Nebulous and Unlimited "Federal Trust Law" Which Will Govern an Increasingly Large Number of Indenture Defaults

The decision of the Court of Appeals majority threatens to impose a new and nebulous federal law of trusts upon indenture trustees more than forty years after the Act was passed. During those forty years, disputes

9. The Court of Appeals majority also argued that absent an original federal forum, this Court would be unable to resolve conflicting interpretations of the Act. (App. A21). This very point was squarely rebutted more than a decade ago in a *Harvard Law Review* article which concluded that even though suits for breach of a mandatory indenture provision did not "arise under" the Act so as to vest original federal question jurisdiction in the federal district courts, this Court could nevertheless review federal questions arising in state court suits under the Act. *See* Greene, *Hybrid State Law in the Federal Courts*, 83 Harv. L. Rev. 289, 318 (1969). *Accord*, ALI Federal Securities Code xxxviii (1980).

regarding breaches of indenture provisions mandated by the Act have continued, with few exceptions, to be litigated in the state courts under state contract and trust law.[10] The importance of a diversion of such cases into the federal courts is obvious. During fiscal 1977 alone, for example, 358 trust indentures relating to nearly 25 billion dollars in securities were filed with the SEC.[11] Moreover, the generally favorable financial conditions between 1940 and 1970, which held down the number of cases adjudicating the duties of indenture trustees under the Act,[12] have now been replaced with sharply deteriorating financial conditions which have increased the number of corporate bankruptcies[13] and debenture defaults,[14] bringing to

10. *See, e.g., Haas v. Palace Hotel Co.*, 101 Cal. App. 2d 108, 224 P. 2d 783 (1950), *cert. denied*, 342 U. S. 813 (1951); *Young v. Distinctive Devices, Inc.*, No. 1119 (N. Y. Ct. App., Dec. 13, 1979), *cert. denied*, 48 U. S. L. W. 3733 (1980); *Ray v. Marine Midland Grace Trust Co.*, 35 N. Y. 2d 147, 359 N. Y. S. 2d 28 (1974); *United States Trust Co. v. First National City Bank*, 57 A. D. 2d 285, 394 N. Y. S. 2d 653 (App. Div. 1977); *Galdo v. First Pennsylvania Bank N. A.*, 250 Pa. Super. Ct. 385, 378 A. 2d 990 (1977).

11. 43 SEC Ann. Rep. 118 (1977).

12. *See Fidelity Mortgage Investors v. First National City Bank*, 387 F. Supp. 544, 546 (S. D. N. Y. 1974); Johnson, *Default Administration of Corporate Trust Indentures: The General Nature of the Trustee's Responsibility and Events of Default*, 15 St. Louis U. L. J. 203 (1970).

13. One analyst, noting the "staggering" growth of corporate bankruptcies over the past decade, has estimated that between 1969 and 1979, the number of annual business filings for bankruptcy mushroomed by 91 percent, from 15,430 to 29,500. N. Y. Times, Jan. 6, 1980, § 12 (National Economic Survey), at 50.

14. For example, between 1972 and 1977, Morgan Guaranty Trust Co. of New York, which administers over 500 trust indentures, experienced its heaviest period of defaults since the 1930's. By contrast, Morgan experienced only two defaults from 1950

the judicial forefront the pressing questions now presented for definitive determination by this Court. Indeed, since 1975 alone, four district courts [15] and now, for the first time, a federal court of appeals, have ruled upon the important legal issue expressly reserved by this Court in *Caplin*.

The importance of the decision below is also highlighted by its coverage in the financial and legal press [16] and by the participation of the SEC in the Court of Appeals oral argument, an extraordinary step which was permitted only after the SEC argued in its motion papers that the present case posed "an important issue" and "could significantly affect future enforcement of the Act." [17]

Whether cases such as the present one should be litigated in federal courts poses a question at the heart of this Court's most basic concerns. As Mr. Chief Justice Warren told the American Law Institute some twenty-one years ago:

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14. (Cont'd.)
through 1969. Memorandum from Davis Polk and Wardwell to Professor Louis Loss (Jan. 10, 1977) (submitted in connection with the proposed Federal Securities Code).

15. In addition to the decision of the District Court herein, *see Mathews v. Fisher*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,336 (S. D. Ohio 1978); *In re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161, 203 (C. D. Cal. 1976), *aff'd on other grounds*, 603 F. 2d 1353 (9th Cir. 1979); *Morris v. Cantor*, 390 F. Supp. 817 (S. D. N. Y. 1975).

16. *See, e.g.*, Wall St. J., June 2, 1980, at 31; 48 U. S. L. W. 2823 (1980); 48 U. S. L. W. 2077 (1979); 557 Sec. Reg. & L. Rep. (BNA), at A13 (1980); [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,514 (1980); Pa. L. J., June 23, 1980, at 1.

17. Motion of the Securities and Exchange Commission, Amicus Curiae, For Leave to Participate in Oral Argument, pp. 1, 2 (Jan. 10, 1980).

> " 'It is essential that we achieve a proper jurisdictional balance between the federal and state court systems, assigning to each system those cases most appropriate in the light of the basic principles of federalism.' " [18]

Echoing those same concerns this year, Mr. Chief Justice Burger warned the same group of an emerging tendency to merge state and federal court jurisdiction which might well end, if unchecked, in "an irreversible erosion" of these "basic principles of federalism." [19] If litigation involving breach of contract provisions included in qualified trust indentures is now to be diverted from state to federal courts some forty-one years after enactment of the Trust Indenture Act, a due regard for these "basic principles of federalism" requires review by this Court of the split decision of the Court of Appeals in this important case.

B. The Court of Appeals Decision Conflicts With This Court's Decisions in Transamerica Mortgage Advisors, Inc. v. Lewis and Touche Ross & Co. v. Redington

Since 1972, when the question whether a federal private right of action exists under the Trust Indenture Act was explicitly reserved by this Court in *Caplin v. Marine Midland Grace Trust Co., supra,* this Court has decided numerous cases which sharply restrict the instances in which a federal private right of action may be implied under the federal securities laws and other federal legislation.[20] These cases, culminating in *Transamerica*

18. American Law Institute, *Study of the Division of Jurisdiction Between State and Federal Courts* 1 (1968), *quoting* American Law Institute Proceedings 33 (1959).

19. Welcoming Remarks of Mr. Chief Justice Burger, American Law Institute 1980 Annual Meeting, Washington, D. C., June 10, 1980, p. 5.

20. *See, e.g., Kissinger v. Reporters Committee for Freedom of the Press,* 48 U. S. L. W. 4223 (U. S. March 3, 1980) (no private

Mortgage Advisors, Inc. v. Lewis, supra, and *Touche Ross & Co. v. Redington, supra,* mandate a "stricter standard" of statutory construction for implying a right to sue where Congress has not explicitly provided such a right. Under that standard:

> "The central inquiry remains whether Congress *intended* to create, either expressly or by implication, a private cause of action. . . . *[Where] the statute by its terms grants no private rights to any identifiable class and proscribes no conduct as unlawful . . . and the legislative history . . . does not speak to the issue of private remedies . . . , the inquiry ends there: The question whether Congress, either expressly or by implication, intended to create a private right of*

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20. (Cont'd.)

right of action under Federal Records Act); *Transamerica Mortgage Advisors, Inc. v. Lewis, supra* (no private right of action for damages under § 206 or § 215 of Investment Advisers Act); *Touche Ross & Co. v. Redington, supra* (no private right of action under § 17(a) of 1934 Act); *Chrysler Corp. v. Brown,* 441 U. S. 281 (1979) (no private right of action under Trade Secrets Act); *Santa Fe Indus., Inc. v. Green,* 430 U. S. 462 (1977) (no private right of action under Rule 10b-5 for breach of corporate fiduciary duty not involving manipulation or deception); *Piper v. Chris-Craft Indus., Inc.,* 430 U. S. 1 (1977) (no private remedy in favor of a tender offeror claiming misrepresentation by a competing tender offeror); *Ernst & Ernst v. Hochfelder,* 425 U. S. 185 (1976) (no private right of action for damages under § 10(b) of 1934 Act in absence of an allegation of scienter); *Cort v. Ash,* 422 U. S. 66 (1975) (no private right of action on behalf of corporation for violations of statute prohibiting corporate election contributions); *Rondeau v. Mosinee Paper Corp.,* 422 U. S. 49 (1975) (restricting class of private litigants who may obtain injunctive relief under § 13(d) of 1934 Act to those who can show "irreparable harm"); *Securities Investor Protection Corp. v. Barbour,* 421 U. S. 412 (1975) (no private right of action to compel SIPC to act available to customers under the SIPA of 1970.

action, has been definitely answered in the negative." *Touche Ross*, 442 U. S. at 575-76. (Emphasis added).

The majority opinion of the Court of Appeals in the present case is a classic example of the kind of "judicial legislation" which this stricter standard of statutory construction was designed to prohibit. The Court of Appeals majority disregarded several key features of the Trust Indenture Act which *Lewis* and *Touche Ross* identified as evidence that Congress did *not intend* to create an unspoken federal right to sue:

(1) The sections of the Trust Indenture Act relied upon by plaintiffs simply require the inclusion of certain provisions in the private trust indenture contract. Thus, those sections begin by stating, "The indenture to be qualified shall contain provisions requiring" certain actions. (App. A64-A80). *Touche Ross*, however, held that in all of the prior decisions of this Court finding an implied right of action, "the statute in question at least *prohibited certain conduct* or *created federal rights* in favor of private parties." 442 U. S. at 569. (Emphasis added). This, the Trust Indenture Act does not do, in the sections relied upon by plaintiffs. In contrast to those sections of the Act which impose criminal penalties for specific statutory violations (App. A62-A64, A82-A83), the sections of the Act relied upon by plaintiffs neither prohibit any conduct nor declare any conduct unlawful. Moreover, in contrast with section 323 of the Act, which expressly grants security holders a federal right of action for damages under circumstances not alleged in this case (App. A81-A82), the sections of the Act upon which plaintiffs rely concededly contain no language which even purports to create any federal rights or remedies in favor of security holders.

(2) The Court of Appeals majority implied a federal private right of action even though it expressly conceded

that the "legislative history of the Act does not explicitly deal with the ability of investors to bring suit in federal court." (App. A16). *Touche Ross* instructed, however, that "implying a private right of action on the basis of congressional silence is a hazardous enterprise, at best," particularly where, as here, "the plain language of the provision weighs against implication of a private remedy." 442 U. S. at 571.

Indeed, as set forth above,[21] the legislative history of the Act clearly confirms that Congress' silence regarding federal enforcement of trust indenture contracts was purposeful. *See Kissinger, supra,* 48 U. S. L. W. at 4226. In order to cure the specific deficiencies that were prevalent in trust indenture contracts of the time, Congress chose simply to require, permit or prohibit the inclusion of certain specified terms in the indenture contract. There is no evidence, however, that Congress intended to displace or preempt the traditional jurisdiction of *state courts* over the *enforcement* of those private contracts. Thus, as numerous commentators have recognized,[22] the legislative history of the Act indicates that Congress considered the existing body of common law and state court enforcement procedures entirely sufficient to protect investors once certain minimum provisions were written into, and certain artificial barriers to liability were removed from, the private trust indenture contract.[23]

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21. *See* pp. 7-11 *supra.*

22. *See, e.g.,* Dropkin, *Implied Civil Liability Under the Trust Indenture Act: Trends and Prospects,* 52 Tul. L. Rev. 299, 323 (1978); Greene, *Hybrid State Law in the Federal Courts,* 83 Harv. L. Rev. 289, 318 (1969); Stark, *The Trust Indenture Act of 1939 in the Proposed Federal Securities Code,* 32 Vand. L. Rev. 527, 543 (1979).

23. In fact, since the passage of the Act, state courts have continued to exercise their traditional jurisdiction over the enforcement of trust indenture contracts. *See* cases cited at p. 13 n. 10 *supra.*

(3) In *Lewis*, this Court specifically cited section 323 of the Trust Indenture Act as demonstrating that " 'when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly.' " 444 U. S. at 20-21 & n. 10. (Citation omitted). Given the private right of action for damages explicitly granted to security holders in section 323 (App. A81-A82), no further federal private rights of enforcement may be implied. See *National Railroad Passenger Corp. v. National Association of Railroad Passengers*, 414 U. S. 453, 458 (1974). As this Court emphasized in *Lewis*:

> "[I]t is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." 444 U. S. at 19.

(4) Many of the mandatory provisions of the Trust Indenture Act relied upon by plaintiffs perform a function similar to that performed by section 17(a) of the Securities Exchange Act of 1934, which was held by this Court in *Touche Ross* not to give rise to an implied private right of action for damages. Section 17(a) of the 1934 Act requires certain reports to be filed "for the protection of investors." Sections 313 and 315(b) of the Trust Indenture Act, which the Court of Appeals held gave rise to an implied federal right of action, similarly require the indenture trustee merely to transmit certain reports and notices.[24] (App. A76-A80). *Touche Ross* concluded that such statutes are "forward-looking, not retrospective; [they seek] to forestall insolvency, not to provide recompense after it has occurred." 442 U. S. at 570-571. Here, as in

24. Plaintiffs allege that First Pennsylvania violated provisions of the Indenture required by these sections of the Act. *See* p. 3 *supra*.

Touche Ross, the intent of these sections of the Trust Indenture Act is evident from their face—they are merely reporting devices which do not, by any stretch of their language, purport to confer a federal right to sue for damages upon an affected security holder.[25]

In addition to ignoring these significant indicia that Congress did *not* intend to federalize the enforcement of private trust indenture contracts, the Court of Appeals majority misapplied this Court's recent decision in *Transamerica Mortgage Advisors, Inc. v. Lewis, supra*. *Lewis* rejected an implied private right of action under the Investment Advisers Act of 1940 even though it found that section 206 of that Act established "federal fiduciary duties" which Congress clearly intended to be "enforceable," and that plaintiffs in that case were the intended beneficiaries of section 206.

Ironically, the Court of Appeals majority opinion stood *Lewis* on its head by relying on this Court's additional holding in *Lewis* that a limited private right of action for *injunctive* relief could be implied under language in section 215 of the Advisers Act which declares that contracts made in violation of the Advisers Act "*shall be void.*" (App. A17-A19). That holding, however, provides no support whatsoever for implying a private right of action under the Trust Indenture Act.

First, as this Court emphasized in *Lewis*, the language of Section 215 of the Advisers Act declaring certain contracts "void" *expressly* creates or alters civil liabilities. 444 U. S. at 19. That section has no counterpart in the provisions of the Trust Indenture Act relied upon by plaintiffs, which merely require that certain provisions be

25. Indeed, the legislative history clearly indicates that the Act as a whole was intended to serve a *prophylactic*, not a remedial, function. *See, e.g.*, House Report, *supra*, at 26; Senate Report, *supra*, at 8; 84 Cong. Rec. 5007 (1939) (remarks of Sen. Barkley).

included in a qualified indenture. (App. A64-A80). Indeed, as Judge Layton stressed in his dissenting opinion in the Court of Appeals, the Advisers Act voidness language is "completely foreign to the provisions of the [Trust Indenture] Act here under consideration." (App. A26). Moreover, *Lewis* specifically held that such language gave rise only to specific and limited equitable relief, such as a suit for rescission, and did not authorize plaintiffs to recover damages under Section 215 for the diminution in the value of their investments—the very relief sought by plaintiffs herein. 444 U. S. at 24 n. 14. Further undermining the reliance of the Court of Appeals opinion upon *Lewis* is the fact that the legislative history of the Trust Indenture Act—unlike the legislative history of the Advisers Act—indicates that Congress fully intended aggrieved investors (in the words of Judge Layton) "to use the state, not federal, courts for a remedy." (App. A27).

Finally, the Court of Appeals also erred in holding that the judicial implication of a federal private right of action would be a "necessary and helpful" means of protecting security holders and effectuating the supposed remedial purposes of the Act. While such an analysis was once given currency in *J. I. Case Co. v. Borak*, 377 U. S. 426 (1964), this Court has subsequently limited *Borak* in favor of "a stricter standard for the implication of private causes of action." *Touche Ross*, 442 U. S. at 578. Under this Court's "stricter standard" of statutory construction, arguments "concerning the 'necessity' of implying a private remedy" have "little relevance" where, as here, neither the language nor the legislative history of the Act support the implication of a federal private right of action. *Touche Ross*, 442 U. S. at 575.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

EDWARD F. MANNINO
2600 The Fidelity Building
Philadelphia, Pennsylvania 19109
(215) 546-3000

Attorney for Petitioner
First Pennsylvania Bank N. A.

Of Counsel:

DILWORTH, PAXSON, KALISH & LEVY
MARK J. LEVIN
2600 The Fidelity Building
Philadelphia, Pennsylvania 19109

APPENDIX

Statutes Involved

Additional Relevant Sections of the Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.*

Section 301, 15 U.S.C. §77aaa. Short title.

This subchapter may be cited as the "Trust Indenture Act of 1939."

Section 309(d) and (e), 15 U.S.C. §77iii(d) and (e). When qualification becomes effective; effect of qualification.

(d) No trustee under an indenture which has been qualified under this subchapter shall be subject to any liability because of any failure to such indenture to comply with any of the provisions of this subchapter, or any rule, regulation, or order thereunder.

(e) Nothing in this subchapter shall be construed as empowering the Commission to conduct an investigation or other proceeding for the purpose of determining whether the provisions of an indenture which has been qualified under this subchapter are being complied with, or to enforce such provisions.

Section 315, 15 U.S.C. §77ooo. Duties and responsibility of the trustee—Duties prior to default.

(a) The indenture to be qualified may provide that, prior to default (as such term is defined in such indenture)—

(1) the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture; and

(2) the indenture trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, in the absence of bad faith on the part of such trustee, upon certificates or opinions conforming to the requirements of the indenture;

but such indenture shall contain provisions requiring the indenture trustee to examine the evidence furnished to it pursuant to section 77nnn of this title to determine whether or not such evidence conforms to the requirements of the indenture.

Notice of defaults

(b) The indenture to be qualified shall contain provisions requiring the indenture trustee to give to the indenture security holders, in the manner and to the extent provided in subsection (c) of section 77mmm of this title, notice of all defaults known to the trustee, within ninety days after the occurrence thereof: *Provided,* That such indenture may provide that, except in the case of default in the payment of the principal of or interest on any indenture security, or in the payment of any sinking or purchase fund installment, the trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee, or a trust committee of directors and/or responsible officers, of the trustee in good faith determine that the withholding of such notice is in the interests of the indenture security holders.

Duties of the trustee in case of default

(c) The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

Responsibility of the trustee

(d) The indenture to be qualified shall not contain any provisions relieving the indenture trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that—

(1) such indenture may contain the provisions authorized by paragraphs (1) and (2) of subsection (a) of this section;

(2) such indenture may contain provisions protecting the indenture trustee from liability for any error of judgment made in good faith by a responsible officer or officers of such trustee, unless it shall be proved that such trustee was negligent in ascertaining the pertinent facts; and

(3) such indenture may contain provisions protecting the indenture trustee with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the holders of not less than a majority in principal amount of the indenture securities at the time outstanding (determined as provided in subsection (a) of section 77ppp of this title) relating to the time, method, and place of conducting any proceeding for any remedy available to such trustee, or exercising any trust or power conferred upon such trustee, under such indenture.

Undertaking for costs

(e) The indenture to be qualified may contain provisions to the effect that all parties thereto, including the indenture security holders, agree that the court may in its discretion require, in any suit for the enforcement of any right or remedy under such indenture, or in any suit against the trustee for any action taken or omitted by it as trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorney's fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant: *Provided,* That the provisions of this subsection shall not apply to any suit instituted by such trustee, to any suit instituted by any indenture security holder, or group of indenture security holders, holding in the aggregate more than 10 per centum in principal amount of the indenture securities outstanding, or to any suit instituted by any indenture security holder for the enforcement of the payment of the principal of or interest on any indenture security, on or after the respective due dates expressed in such indenture security.

Section 319(c), 15 U.S.C. §77sss(c). Rules, regulations and orders.

(c) No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

Section 322(b), 15 U.S.C. §77vvv(b). Court review of orders; jurisdiction of offenses and suits.

(b) Jurisdiction of offenses and violations under, and jurisdiction and venue of suits and actions brought to enforce any liability created by, this subchapter, or any rules or regulations or orders prescribed under the authority thereof; shall be as provided in Section 77v(a) this title.

Jurisdiction of offenses and suits.

Section 22, 15 U.S.C. §77v(a).

(a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.